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No. _____

IN THE
Supreme Court of the United States

October Term, 1983

LUCILE LOWRY and LOWRY-ZWEIG CORP.,

Petitioners,

vs.

THE BALTIMORE & OHIO RAILROAD COMPANY,
THE CHESAPEAKE & OHIO RAILROAD COMPANY,
and CHESIE SYSTEM, INC.,

Respondents.

**PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT**

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QUESTIONS PRESENTED FOR REVIEW

Respondents' liability to petitioners turns on two discrete issues: (a) whether respondents violated § 10(b) of the Securities Exchange Act of 1934; and (b) whether the claim under § 10(b) was assigned to petitioners by operation of law. The District Court held in favor of assignment, but later dismissed the action on the ground that respondents did not violate § 10(b). The Third Circuit, in banc, ruled 6-2 that respondents were liable under § 10(b), but split 3-3 on the assignment issue (with two judges refusing to consider that question). Nevertheless, dismissal of petitioners' § 10(b) claim was affirmed.

This Petition presents the following questions for review:

1. Was the Court of Appeals empowered to reverse the District Court's ruling in favor of assignment when the circuit judges were equally divided on the question?
2. Are claims under § 10(b) assigned by operation of law as an incident to the transfer of the underlying debt securities? (Insofar as the judgment below rules against such assignment, the Third Circuit is in conflict with the Second.)

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OPINIONS BELOW

The opinion of the United States Court of Appeals for the Third Circuit, in banc, is reported at 707 F.2d 721. (1a) A subsequent decision denying petitioners' Petition for Modification of the Per Curiam Opinion and Judgment is unreported. (69a)

The opinion and order of the District Court dismissing the complaint herein is not officially reported. (60a, 62a) The opinion of the District Court with respect to the assignment issue is also unreported. (64a, 66a)

JURISDICTION

The Judgment of the Third Circuit is dated May 10, 1983. (68a) Petitioners' subsequent Petition for Modification of Per Curiam Opinion and Judgment was denied by decision dated July 5, 1983. (69a) Jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

Due to their length, the statutes involved in this case are set forth in the Appendix. The statute and rule relating to liability are:

Section 10(b), Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78j(b).....	89a
Rule 10b-5, 17 C.F.R. § 240.10b-5.....	89a

Statutes relating to the assignment question are:

New York General Obligations Law, § 13-107 (McKinneys 1978)	91a
Uniform Commercial Code, § 8-301	90a

STATEMENT OF THE CASE

The Claim

Petitioners commenced this class action on October 22, 1979 to recover damages arising out of respondents' alleged violation of § 10(b) of the Exchange Act, rules promulgated thereunder and principles of common law. Federal jurisdiction was based upon § 27 of Exchange Act, 15 U.S.C. § 78aa, diversity of citizenship, 28 U.S.C. § 1332, and pendent jurisdiction.

The Facts¹

Respondent, Baltimore & Ohio Railroad ("B&O"), is the issuer of convertible debentures listed on the New York Stock Exchange.² Holders of these debentures have the right to convert them at any time into B&O common stock at a rate of ten shares of stock for each \$1,000 of face value. At the time of the violations alleged, over 99% of B&O's common stock was owned by respondent, The Chesapeake & Ohio Railroad Co. ("C&O"), which, in turn, was a subsidiary of respondent, Chessie System, Inc. ("Chessie"), a holding company.³

In 1977, Chessie management decided to separate B&O's railroad-related assets from its "non-rail" assets, so the latter could be developed free from restrictive Interstate Commerce Commission regulations. The method chosen to effect this segregation was transfer of the non-rail assets to Mid-Allegheny Corp. ("MAC"), a wholly-owned subsidiary of B&O created for that purpose, followed by distribution of MAC stock as a dividend to B&O's shareholders. Thereby, over 99% of the MAC stock (and control of the non-rail assets) would be upstreamed from B&O to C&O, and eventually to Chessie.

Between 1961 and 1977, no dividends were paid on B&O common stock. "Thus," as the Court of Appeals observed in *Pittsburgh Terminal*, *supra*, 680 F.2d at 936, "the holders of convertible debentures had no particular incentive to exercise the conversion privilege unless the no dividend policy were to change." Recognizing that the planned MAC dividend would provide the needed incentive, respondents devised a scheme to prevent debenture-holders from exercising their conversion

¹ Summary judgment, dismissing this action, was granted following trial of a related private action, *Pittsburgh Terminal Corp. v. Baltimore & Ohio R.R. Co.*, 509 F. Supp. 1002 (W.D. Pa. 1981), *rev'd*, 680 F.2d 933 (3d Cir.), *cert. denied*, 103 S.Ct. 476 (1982). The facts as presented in this Petition derive from findings in the companion case and are largely undisputed.

² B&O Series A, dated January 1, 1956, maturing January 1, 2010, bearing interest at 4.5%.

³ There were thirteen other holders of B&O common stock besides C&O.

privilege. (Conversions, of course, would have diluted respondents' interest in the non-rail assets.⁴)

On December 14, 1977, B&O publicly announced that on the previous day it had declared a dividend payable in MAC stock (on a share for share basis) to all B&O shareholders of record as of December 13, 1977. By making the record date the same as the declaration date—and then announcing both dates only after they had passed—respondents intended to, and did, prevent debenture-holders from converting into B&O stock in order to receive the MAC dividend. The adverse effect of this scheme upon debenture-holders is plain: prior to the MAC dividend, debenture-holders had a right to convert into B&O stock which represented both the rail and non-rail assets; after the MAC dividend, debenture-holders could convert only into shares of B&O which had been stripped of its non-rail assets. (B&O's non-rail assets, according to one of respondents' estimates, were worth \$122 million, or \$45-\$55 per B&O share⁵).

In *Pittsburgh Terminal*, *supra*, 680 F.2d 933, the Third Circuit held that respondents' scheme was a violation of § 10(b). In that case, respondents' petition for rehearing in banc was denied; and this Court denied certiorari. 103 S.Ct. 476 (1982). Accordingly, respondents are now collaterally estopped from relitigating their § 10(b) liability.

Petitioners in the instant case (an individual and her husband's personal holding company) purchased B&O debentures on the open market after December 13, 1977, the date of the MAC dividend.⁶ Petitioners contend that all rights of action

⁴ The reason advanced by respondents for their acknowledged frustration of debenture-holders' conversion rights was avoidance of filing a costly registration statement with the Securities and Exchange Commission. The SEC urged, and the Court of Appeals held, that this was no defense under § 10(b). *Pittsburgh Terminal*, *supra*, 680 F.2d at 942.

⁵ As noted, each \$1,000 B&O debenture was convertible into 10 shares of B&O common stock. The MAC dividend thus decreased the future conversion value of each \$1,000 debenture by at least \$450 to \$550.

⁶ Petitioners purchased their B&O debentures with knowledge of the alleged violation (and later purchases were made with knowledge also of the suit filed by *Pittsburgh Terminal*). Petitioners' broker and investment counselor

related to the B&O debentures, including the § 10(b) liability upheld in *Pittsburgh Terminal*, were assigned to them (and other later purchasers) by operation of law as an incident to the transfer of those securities. Support for this position as a matter of federal law is found in *Phelan v. Middle States Oil Corp.*, 154 F.2d 978, 999-1002 (2d Cir. 1946). In addition, it is beyond dispute that, under state law, analogous fraud claims are assigned on transfer. See Uniform Commercial Code, § 8-301 (90a); N.Y. General Obligations Law § 13-107 (McKinneys 1978) (91a); Opinions below (46a-47a; 56a-57a).

Proceedings Below

On October 22, 1979, petitioners moved in the District Court for class certification citing, *inter alia*, *Phelan*, *supra*, U.C.C. § 8-301 and N.Y. Gen'l Oblig. Law § 13-107. (71a, 72a-74a) In opposition to this motion, respondents contended that petitioners lacked standing to sue because their purchases postdated the alleged violation and that no assignment had been made. Briefs were submitted on the assignment issue (*see, e.g.*, 71a; 79a; 81a), but the District Court withheld ruling on the question as being inappropriate at the class-certification stage.⁷ On April 23, 1980, respondents moved for summary judgment, renewing their argument that petitioners lacked standing because of their late purchases and lack of an assignment. (84a) The parties agreed that this motion could be decided on the papers previously submitted on the class certification motion. (85a at ¶ 8; 87a)

On June 17, 1980, the District Court denied respondents' motion, explicitly noting that the motion was "based (1) on the alleged lack of standing of [petitioners] to sue because of . . . late purchase of the debentures." (66a; *see also*, 64a)

had brought the debentures to petitioners' attention, suggesting that a favorable resolution of the MAC dividend situation might enhance the market value of all outstanding debentures. Following institution of suit by *Pittsburgh Terminal*, the brokerage house of Bache Halsey Stuart Shields, Inc. published a similar buy recommendation. See Bache, *Litigation Review*, Vol. 4, No. 12 (March 7, 1979).

⁷ The District Court did, however, certify a class on April 7, 1980.

In July 1980, the *Pittsburgh Terminal* action went to trial.⁸ On March 10, 1981, the District Court ruled that respondents did not violate § 10(b) (or any other law) and rendered judgment dismissing the action. On the strength of its *Pittsburgh Terminal* decision, the District Court, on May 15, 1981, rendered summary judgment against petitioners and dismissed the complaint herein. (60a; 62a)

Petitioners (and the plaintiffs in *Pittsburgh Terminal*) appealed. The appeals were consolidated and heard by a panel of the Third Circuit on December 16, 1981. In *Pittsburgh Terminal*, the panel reversed the District Court, held that respondents were liable under § 10(b) and remanded for a determination of appropriate relief. 650 F.2d 933, 943. Rehearing in banc and certiorari were later denied. *Id.*; 103 S.Ct. 476.⁹

In the instant case, however, the panel was unable to reach a decision. The full court ordered rehearing in banc and propounded six questions, all relating to the assignment issue, to be addressed in supplemental briefs. Oral argument was heard by eight circuit judges (two having recused themselves) on November 8, 1982. Post-argument briefs on the assignment question were requested by the court and provided.

On May 10, 1983, some sixteen months after the case was first argued, the Third Circuit issued the opinions and judgment which are the subject of this Petition. (1a) Six judges (Seitz, Ch.J., Adams, Gibbons, Garth, Sloviter and Becker, C.J.J.) took the view that *Pittsburgh Terminal's* finding of liability should be honored "either because it is correct or binding." (5a) Two judges (Aldisert and Hunter, C.J.J.) would overrule *Pittsburgh Terminal*. (*Id.*) On the assignment question, three judges (Seitz, Ch.J., Gibbons and Becker, C.J.J.) held that the § 10(b) claims were assigned to petitioners by operation of law; three others (Adams, Garth and Sloviter, C.J.J.) held that any assign-

⁸ Petitioners' motion for consolidation with *Pittsburgh Terminal* had been denied by the District Court on June 16, 1980.

⁹ *Pittsburgh Terminal* did not present any assignment of claim question; all the *Pittsburgh Terminal* plaintiffs were debenture-holders since prior to December 13, 1977.

ment must be express (which in this case, concededly, it was not). Two judges (Aldisert and Hunter, C.J.J.) refused to address the assignment question for "fear that going off on an alternate ground might dilute the expression of [their] firmly held conviction that [there was] no federal cause of action to assign." (29a-30a).

The net result of these opinions is that the § 10(b) claim stands dismissed notwithstanding that (1) a majority of the Court of Appeals ruled in favor of § 10(b) liability, thereby reversing the sole ground for the District Court's dismissal; and (2) the court was equally-divided on the assignment issue which the District Court had resolved in petitioners' favor. Petitioners brought this anomaly to the Third Circuit's attention in a Petition for Modification of the Per Curiam Opinion and Judgment, but obtained no relief, three judges dissenting. (69a)

REASONS FOR GRANTING THE WRIT

1.

The reversal of the District Court's ruling in favor of assignment by a Court of Appeals equally-divided on the issue flies in the face of this Court's repeated holdings that: "If the judges are divided, the reversal cannot be had, for no order can be made." *Neil v. Biggers*, 409 U.S. 188, 191-2 (1972), *quoting*, *Durant v. Essex Co.*, 7 Wall 107, 112 (1869). Nor can the dismissal of petitioners' § 10(b) claim be justified on the ground that five of the eight judges favored dismissal, albeit for differing reasons. As Judge Gibbons stated in his opinion below:

The entry of a judgment based on two legal propositions, neither of which commands a majority, is a disgrace to the judicial process. The scandal is compounded by the fact that two judges have voted to rest the judgment on grounds which the defendants are collaterally estopped from asserting.

(50a)

In response to the Petition to Modify the Per Curiam Opinion and Judgment, Judge Gibbons again wrote separately. He pointed out that in *United States v. Bazzano*, No. 81-1836, a case argued to the Third Circuit, in banc, on the same day as the case at bar, no majority of the court could agree upon a reason to reverse as to a certain issue and accordingly the District Court's ruling on that issue was affirmed. As Judge Gibbons wrote:

No explanation has been proffered by the court [of appeals] for the inconsistent treatment of litigants with respect to an identical issue of appellate procedure arising in two cases argued on the same day. No explanation that could stand public scrutiny can be given.

* * *

[I]f the Supreme Court is concerned about public perceptions as to the integrity of the federal appellate process, it should grant certiorari in this case and formally vacate the unsupportable judgment of this court.

(70a-70.1a)

In short, an obvious and grave injustice has been perpetrated by the court below which reflects adversely on the federal judiciary. Petitioners submit that the case at bar is an appropriate instance for this Court to exercise its general supervisory control over the federal court system (*cf. LaBuy v. Howes Leather Co.*, 352 U.S. 249, 259-60 (1957)), by granting certiorari and directing that petitioners' federal claim be reinstated.¹⁰

¹⁰ Petitioners consider that they are also entitled to a writ of mandamus directing that petitioners' § 10(b) claim be reinstated because the divided Court of Appeals had no power to reverse. Because it is felt that complete relief can be had by writ of certiorari, mandamus is not specifically requested. If, however, this Court is of the view that mandamus is the more appropriate remedy, it is requested that this Petition be considered as one seeking a writ of mandamus pursuant to 28 U.S.C. § 1651. *Cf. In re Simons*, 247 U.S. 231, 239-40 (1918).

Aside from rectifying a glaring malfunction of the judicial process, petitioners seek certiorari in order to resolve a conflict between the circuits. The inescapable result of the decision below is that the complaint has been dismissed, not because there was no violation of § 10(b) but because a claim based on that violation did not pass to petitioners by operation of law. This result directly conflicts with the Second Circuit's decision in *Phelan v. Middle States Oil Corp.*, 154 F.2d 978, 999-1002 (2d Cir. 1946), holding that federal claims pass by operation of law as an incident to the transfer of debt securities.

In addition, by creating an anti-assignment rule for federal claims which is the precise opposite of the uniform rule for state law claims, the court below exposes respondents to double liability and will further complicate the judicial management of this and other complex cases. See 23a, n.16; 48a-50a.¹¹ A grant of certiorari in the present case will permit this Court to resolve these issues of importance to litigation under the federal securities laws.

ARGUMENT

A. *The Equally-Divided Court Of Appeals Had No Power To Reverse The District Court's Ruling In Favor Of Assignment*

Respondents made two motions for summary judgment in the District Court. The first, based on petitioners' alleged lack of standing, squarely raised the assignment issue. (66a, 71a, 79a, 81a, 84a) The District Court, in denying this motion (64a), necessarily ruled in favor of assignment. Respondents' second

¹¹ Under the ruling below, respondents (and others in analogous positions) are liable under federal law to those who held bonds at the time of the wrong and liable under state law to the ultimate holders (*i.e.*, assignees) of the bonds. Thus, for each bond transferred, respondents will have to pay damages twice. Two of the judges below recognized this injustice, but did not let it alter their view that federal claims are not automatically assigned upon transfer, even though state claims plainly are. (23a, n. 16).

motion came after the judgment of dismissal in *Pittsburgh Terminal*. The District Court, in granting this motion, held that respondents did not violate § 10(b). (62a) In no way did this second ruling conflict with, or overturn, the earlier ruling in favor of assignment; the two issues were entirely discrete.

On appeal, both issues were presented to the Court of Appeals. The panel ruling in *Pittsburgh Terminal*, *supra*, 680 F.2d 933, determined the first issue: that respondents did in fact violate § 10(b). That holding became final when this Court denied certiorari, but in any event the Third Circuit, in banc, in this case reaffirmed the *Pittsburgh Terminal* panel's result. (5a) Thus, the District Court's sole ground for dismissal of the instant action was held to be erroneous by the Court of Appeals, in banc. The second question before the Court of Appeals was whether the District Court was correct in upholding the claimed assignment by operation of law. On this question the Court of Appeals split 3-3.

In *Neil v. Biggers*, 409 U.S. 188, 191-2 (1972), this Court explained its long-held view that an equally-divided court lacks the power to reverse a ruling of the lower court:

In this light, we review our cases explicating the disposition "affirmed by an equally divided Court." On what was apparently the first occasion of equal division, *The Antelope*, 10 Wheat 66, 6 L.Ed. 268 (1825), the Court simply affirmed on the point of division without much discussion. *Id.*, at 126-127, 6 L.Ed. 268. Faced with a similar division during the next Term, the Court again affirmed, Chief Justice Marshall explaining that "the principles of law which have been argued, cannot be settled; but the judgment is affirmed, the court being divided in opinion upon it." *Etting v. Bank of the United States*, 11 Wheat 59, 78, 6 L.Ed. 419 (1826). As was later elaborated, in such cases it is the appellant or petitioner who asks the Court to overturn a lower court's decree.

"If the judges are divided, the reversal cannot be had, for no order can be made. The judgment

of the court below, therefore, stands in full force. It is, indeed, the settled practice in such case to enter a judgment of affirmance; but this is only the most convenient mode of expressing the fact that the cause is finally disposed of in conformity with the action of the court below, and that that court can proceed to enforce its judgment. The legal effect would be the same if the appeal, or writ of error, were dismissed." *Durant v. Essex Co.*, 7 Wall 107, 112, 19 L.Ed. 154 (1869).

Petitioners submit that in the present case "the legal effect" of the Third Circuit's equal division should be the same as if the appeal "were dismissed" with respect to the assignment issue, *i.e.*, the District Court's ruling in favor of assignment stands.¹²

Respondents have suggested that it is improper to look at individual legal *issues*; rather, that one should look at the District Court's ultimate *judgment* of dismissal and the fact that five of the eight judges on the Court of Appeals agree with that *judgment*, even if for differing reasons. This view has no support in law or logic.

In *Jones v. Diamond*, 636 F.2d 1364 (5th Cir.) (in banc), *cert. dismissed*, 453 U.S. 950 (1981), the Fifth Circuit Court of Appeals, in banc, reviewed the District Court's judgment dismissing a variety of claims that prison conditions violated the United States Constitution. On most issues, the court had a majority in favor of reversal. As to one issue, however, the court was equally divided and therefore affirmed. 636 F.2d at 1376. As a result, the District Court's judgment was affirmed in part (by an equally-divided court) and reversed in part. A similar result obtained in

¹² Even were there no District Court ruling on the assignment issue, petitioners could not properly be deprived of their § 10(b) claims on the strength of an even division on the assignment question in the Court of Appeals. In that posture, if this Court were disinclined to deal with the substantive assignment question, it might be expected to vacate the dismissal of the § 10(b) claim and direct the District Court to rule on assignment. Such a disposition would be regrettable in this case, however, because of the further an endless delay necessarily entailed and the inversion of the District Court's being ordered to resolve a question that has stymied the Court of Appeals.

United States v. Holmes, 537 F.2d 227 (5th Cir. 1976) (in banc), where the court was divided 8-8 on several issues, and therefore affirmed as to those issues, but reversed as to others where a majority was attained.

Oddly enough, the Third Circuit itself has quite recently addressed *issues* separately and, when evenly divided on a particular *issue*, affirmed. See *United States v. Bazzano*, No. 81-1836 (3d Cir. June 17, 1983) (in banc), the case compared to the present one by Judge Gibbons (70a) who condemned the "inconsistent treatment of litigants with respect to an identical issue of appellate procedure arising in two cases argued on the same day."

Patently a judgment can be no more than the sum of its parts: the various rulings which are required to reach the ultimate conclusion. The judgment of dismissal herein cannot rightfully be upheld when both of its component rulings are in petitioners' favor.

Nor can the judgment be upheld because a "head count" of judges reveals that five of the eight are in favor of dismissal. Two of these five (Aldisert and Hunter) held in favor of dismissal because they believed there was no § 10(b) violation. If the judgment below is sustained on the basis of a "head count", then petitioners' complaint has been dismissed on the strength of a minority opinion which conflicts squarely with the holding of the full court and which espouses a view that respondents are collaterally estopped from asserting. Equally distressing is the announced refusal of these two judges to address the crucial assignment issue with the six other judges at an impasse sixteen months after the initial argument. It was a stark miscarriage of justice to affirm dismissal herein on the votes of two judges who were in the minority on one issue and refused to consider the second.

B. Claims Under The Federal Securities Laws Pass With The Underlying Debentures

The ultimate result reached below, that the § 10(b) claims were *not* automatically assigned to petitioners, is erroneous as a matter of substantive law. The Third Circuit and the Second

Circuit are in conflict as to this important question under federal law.

It is undisputed that claims under § 10(b) are assignable. *International Ladies' Garment Workers' Union v. Shields & Co.*, 209 F. Supp. 145, 149-50 (S.D.N.Y. 1962); *Mills v. Sarjem Corp.*, 133 F. Supp. 753, 761-62 (D. N.J. 1955). *Accord*, *Derdiarian v. Futterman Corp.*, 223 F. Supp. 265, 271 (S.D.N.Y. 1963). See also, *Western Auto Supply Co. v. Gamble-Skogmo, Inc.*, 348 F.2d 736, 741 (8th Cir. 1965), *cert. denied*, 382 U.S. 987 (1966) (holding assignable a claim under § 16(b) of the Exchange Act, 15 U.S.C. § 78p(b), for the recovery of short swing profits). The same holds true for damage actions under the Interstate Commerce Act, *Spiller v. Atchison, T. & S.F. R. Co.*, 253 U.S. 117, 134-35 (1920), and under the federal antitrust laws, *In re Fine Paper Litigation State of Wash.*, 632 F.2d 1081, 1090 (3d Cir. 1980). Thus, the question here is merely whether such an assignment has been effected in this case.

Petitioners submit that this question should be decided as a matter of federal law, especially in view of the federal securities laws' quest for uniformity. State law, however, may provide useful guidance.¹³ In *Sola Electric Co. v. Jefferson Electric Co.*, 317 U.S. 173, 176 (1942), this Court stated:

When a federal statute condemns an act as unlawful, the extent and nature of the legal consequences of the condemnation, though left by the statute to judicial determination, are nevertheless federal questions, the answers to which are to be derived from the statute and the federal policy which it has adopted. To the federal statute and policy, conflicting state law and policy must yield.

¹³ The court below was as divided on this preliminary question as it was on the ultimate. Three judges (Garth, Sloviter and Adams) felt federal law was determinative. (13a) Two (Seitz and Becker) said the result was the same whichever applied, and therefore left the question for another day. (57a) One (Gibbons) felt that federal law determined whether a claim is assignable, but state law governs "fact of assignment." (41a-48a) And two others (Aldisert and Hunter), of course, never opined on the matter at all.

This same rationale applies to claims under § 10(b) of the Exchange Act:

The remedial incidents of this federally created right must, of necessity, also be controlled by federal law, because the policy of uniformity within the federal system at least with respect to the issue at bar is paramount to any interests to be served by conformity with the variousness of state rules.

* * *

More significantly, we are concerned here with an important enforcement provision of a federal statute intended not only to expand the common law but to create new, far-reaching and uniform law of shareholder-management relations in congressionally designated areas of substantive corporation law, which must not under the Supremacy Clause of the Constitution be subordinated to or otherwise hindered by the interposition of state requirements and limitations inconsistent with overriding federal policy.

Drachman v. Harvey, 453 F.2d 722, 728-29 (2d Cir.), holding on this point affirmed, 453 F.2d 736, 737 (2d Cir. 1972) (in banc).

It is, of course, always appropriate under the federal securities laws to look to state law for guidance when the federal statute is silent. *In re The Pittsburgh & L.E.R.Co. Securities and Antritrust Litigation*, 543 F.2d 1058, 1066-67 (3d Cir. 1976); *Western Auto Supply*, *supra*, 348 F.2d at 740-41. Reference to state law is particularly useful here for two reasons: (a) federal decisional law is scant; and (b) because § 28 of the Exchange Act, 15 U.S.C. § 78bb, preserves all state and common law remedies, a divergence between federal and state law as to assignment will open the door to double liability. See n. 11, *supra*; 48a-50a.

Fortunately, state law on assignment is both uniform and well-defined. The Uniform Commercial Code, § 8-301, provides: "Upon delivery of a security the purchaser acquires the

rights in the security which his transferor had or had actual authority to convey" (The 1977 revision of § 8-301, adopted in some states, is to the same effect; 90a.) Similarly, New York General Obligations Law § 13-107 (McKinney 1978) provides:

Unless expressly reserved in writing, a transfer of any bond shall vest in the transferee all claims or demands of the transferrer, whether or not such claims or demands are known to exist, (a) for damages or rescission against the obligor on such bond,

("Bond" is defined to include "debentures or other evidences of indebtedness of . . . corporations.")¹⁴ The commentators are likewise in agreement. *Restatement Second, Contracts*, § 340 (Illustration No. 3 and Reporter's Note regarding Comment b) pp. 87-88 (1981); 3 *Williston On Contracts*, § 432A at p. 200 (3d ed. 1960); 10 C.J.S., *Bills and Notes*, § 203 (1938).

The case of *Phelan v. Middle States Oil Corp.* *supra*, 154 F.2d 978, is in accord with the uniform state rule.¹⁵ In *Phelan*, a bondholder sought to hold a federal receiver liable for misconduct which predated the purchase of his bonds. In an elaborate and well-reasoned opinion, the Second Circuit held, as a matter of federal law, that transfer of the bonds carried with it all related claims, including tort claims for fraud. *Id.* at 999-1002. The court viewed such a rule as preferable both because it was in accord with the expectations of the purchaser and seller of the bond, and because where bearer securities are involved—as in the case at bar—the prior owners are "exceedingly hard to trace", which in practical terms means that wrongdoers would rarely be called to account for their misdeeds and future wrongs

¹⁴ The parties were in agreement below that if state law is determinative, it should be the law of New York, where the debentures are listed and traded and where respondents have numerous substantial contacts. New York law also was chosen as controlling by the signatories to the debenture Indenture.

¹⁵ In 1946, when *Phelan* was decided, the decisional law of New York, then an aberrant jurisdiction, required express assignment. Bowing to criticism of that rule in *Phelan*, the New York Legislature enacted what is now General Obligations Law § 13-107. New York's former law was much criticized elsewhere as well. See, e.g., Corbin, *The Subsequent Bondholder and the Delinquent Trustee*, 51 Col. L. Rev. 813 (1951).

would be undeterred. *Id.* at 1001. The court decided that any possible "windfall" to assignees (which in any event did not enlarge the malefactor's overall liability) was more than outweighed by the need to prevent the wrongdoer from escaping that liability.

The Law Revision Commission, reporting to the New York State Legislature which recommended passage of § 13-107, offered additional reasons why automatic assignment is preferable:

Not only is the [former] rule likely to result in the loss of valid claims because of doubt as to who is entitled to assert them, but it may also make it impossible for an indenture trustee to make a final settlement with bondholders when there is a claim of breach of duty against it. For even payment in full to present holders will not terminate possible claims of former holders, who may be unknown.

* * *

The Commission proposes the abrogation of the present [*i.e.*, former] rule that such causes of action are reserved unless expressly assigned and the adoption of a rule that causes of action are assigned unless expressly reserved. The proposal is limited to transfers of a bond, note or other evidence of indebtedness which constitutes a share or interest in an issue of such securities. Holders of such securities are less likely than assignors of more personal contracts to know about accrued claims for damages. The general use of stereotyped forms of bond transfer and the practice of transfer of bearer bonds by delivery make it unlikely that claims will be expressly assigned even when known to exist. And the freedom with which bonds are transferred between strangers makes it difficult to rectify an omission by procuring a subsequent assignment.

Recommendations of the Law Revision Commission to the Legislature Relating to the Transfer with Bonds of Claims Con-

nected Therewith, Dec. 14, 1949, 9 Leg. Doc. No. 65(D) at 5-7, reprinted in *New York State Law Revision Commission Report, Recommendations and Studies* at 71-73 (1950). The New York Commission also pointed out an unintended result created by the old rule against assignment:

[I]f a bondholder leaves his bonds by will to a specific legatee, and the bonds turn out to be worthless because of a breach of trust by the indenture trustee, the resulting claim for damages will belong, not to the person to whom the bonds were given, but to the residuary legatee under the will.

Id. at 71.

In his opinion below, Chief Judge Seitz offered still another, and perhaps the most important, reason in favor of automatic assignment—*i.e.*, such a rule will further the federal policies underlying § 10(b) of the Exchange Act:

The primary purpose of section 10(b) and the rules promulgated thereunder is to protect investors from manipulative practices in the securities market and to deter such practices in the first instance. Often investors will sell their securities before any fraud or deception is discovered. They will then have little incentive to keep abreast of developments relating to their former investments and thus may never learn of any fraud or deceit. *Assignment of a 10(b) claim places the claim with the person most likely to learn of its existence, thus increasing the remedial purposes of the statute and furthering its deterrence goals.*

A rule of automatic assignment increases the transferability of 10(b) claims and is more likely to advance the policies underlying the federal statute than a rule requiring express assignment. Requiring express assignment in the current securities market would drastically inhibit the effective assignability of 10(b) claims. The vast majority of securities transactions takes place in a faceless market where buyers and sellers never meet and may never have the opportu-

nity to negotiate an express assignment. *Under a rule of automatic assignment, the claim is transferred on purchase to the party most likely to learn of its existence, again maximizing the prophylactic value of the federal statute.*

(36a; emphasis added)

Thus, assignment of § 10(b) claims by operation of law is consistent with the remedial purposes of the federal statute, reflects the expectations of the parties to a securities transaction and eliminates the possibility of double liability which would arise if federal claims were to be treated differently from state law claims.¹⁶

¹⁶ The only contrary federal authority known to petitioners is *Independent Investor Protective League v. Saunders*, 64 F.R.D. 564 (E.D. Pa. 1974), where the District Court held that bondholders' claims under the federal securities laws do not travel with the bonds. But it is obvious that in *Saunders*, the issue was inadequately presented to the court. The opinion calls the plaintiff's theory of automatic assignment "novel," "extraordinary" and "entirely without any support in precedent." *Id.* at 572. The opinion, however, makes no mention of the substantial authority cited above: *Phelan*, U.C.C. § 8-301, N.Y. Gen. Oblig. Law, § 13-107, *Williston, Restatement of Contracts*, etc.

CONCLUSION

For the reasons given above, this Court should grant certiorari and reinstate petitioners' § 10(b) claim. Alternatively, this Court should grant certiorari and rule upon the assignment issue.

Dated: New York, New York
August 8, 1983

Respectfully submitted,

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APPENDIX

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1a

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 81-1976

LUCILE LOWRY and LOWRY-ZWEIG CORP.,
Appellants

vs.

THE BALTIMORE & OHIO RAILROAD COMPANY,
THE CHESAPEAKE & OHIO RAILROAD COMPANY
and
CHESSIE SYSTEM, INC.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA
(D.C. Civ. No. 79-1504)

Argued December 16, 1981

Before: ADAMS, GIBBONS and GARTH, *Circuit Judges.*

Reargued In Banc November 8, 1982

Before: SEITZ, *Chief Judge* and
ALDISERT, ADAMS, GIBBONS, HUNTER, GARTH,
SLOVITER and BECKER, *Circuit Judges.*

(Filed May 10, 1983)

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OPINION OF THE COURT

PER CURIAM.

Lucile Lowry and Lowry-Zweig Corporation appeal from a summary judgment dismissing their class action complaint against the Baltimore & Ohio Railroad Company (B&O), the Chesapeake & Ohio Railway Company (C&O), and the Chessie System, Inc. The complaint alleged that defendants violated §10(b) of the Securities

Exchange Act of 1934, 15 U.S.C. §78j(b); Rule 10b-5 of the Securities and Exchange Commission promulgated thereunder, 17 C.F.R. §240.10b-5 (1981); and state common law when, on December 13, 1977, B&O declared a dividend in favor of its common shareholders in the form of the entire stock of the Mid-Allegheny Corporation. This action was taken without giving notice to holders of B&O convertible debentures, thereby precluding their participation in the dividend distribution. In a previous decision, this court allowed persons who held B&O convertible debentures as of December 13, 1977 to maintain an action under §10(b) and Rule 10b-5. Here, appellants had purchased B&O convertible debentures from persons who held them as of December 13, 1977 and are attempting to assert their sellers' federal cause of action.¹ We conclude that the dismissal of appellants' federal claims was proper and affirm the district court's action as to them. We vacate and remand for further consideration of appellants' state law claims.

The B&O owns both rail and non-rail assets and has issued both common stock and convertible debentures. The C&O controls over 99% of B&O's common stock. There are thirteen other common shareholders and the shares are not publicly traded. The Chessie System is a holding company managing the assets of the C&O. The

1. The class certified by the district court actually included people who had purchased B&O convertible debentures after December 13, 1977, as well as people who had purchased the debentures before December 13, 1977, but had converted them after that date. The assignability question thus bears only on the claims of the first set of class members; we assume, without deciding, that the second set of class members will be covered by the stipulation fashioned by the parties to *Pittsburgh Terminal Corp. v. Baltimore & Ohio R.R. Co.*, 680 F.2d 933 (3d Cir.), cert. denied, 103 S.Ct. 476 (1982), which stipulation provided that holders of debentures as of December 13, 1977, would be treated in the same manner as the *Pittsburgh Terminal* plaintiffs.

present controversy arose after B&O sought to restructure its operations in order to avoid federal restrictions that inhibited development of its non-rail assets. To accomplish this it created the subsidiary corporation, Mid-Allegheny, to which it transferred all of its non-rail assets. Then on December 13, 1977, B&O distributed all of the Mid-Allegheny stock to its own common shareholders. A consequence of this arrangement was that B&O convertible debentures, which previously could have been converted into B&O common stock representing both B&O's rail and non-rail assets, became convertible into B&O common stock representing only B&O's rail assets.

In a separate action, the debenture holders sued under the Securities Exchange Act of 1934 claiming that, as to them, the dividend declaration was fraudulent. They argued that the value of their conversion option, and hence of their convertible debentures, would be reduced unless they were allowed to convert in time to qualify for the Mid-Allegheny dividend. This court agreed, and concluded that B&O had a duty to provide debenture holders with advance notice of such a dividend declaration. *Pittsburgh Terminal Corp. v. Baltimore & Ohio R.R.*, 680 F.2d 933 (3d Cir.), cert. denied, ____ U.S. ____ (51 U.S.L.W. 3420, Nov. 29, 1982).

In the instant suit, appellants purchased B&O convertible debentures from persons who held them on December 13, 1977. Appellants argue that, even though they purchased with full knowledge of the dividend declaration and allege no injury therefrom, the federal cause of action established in *Pittsburgh Terminal* was automatically assigned to them upon their purchase of the debentures.

A majority of this court, albeit for diverse reasons, agree with the district court and conclude that appellants may not maintain a claim for which relief can be granted based on any violation of federal statutes or reg-

ulations. Two judges would overrule *Pittsburgh Terminal* and are of the opinion that B&O was under no legal obligation to provide holders of the convertible debentures with advance notice of the dividend. According to this view, if the prior holders have no federal cause of action, then *a fortiori*, neither do their purchasers, and the assignability issue need not be reached. Six members of the court are of the view that the holding in *Pittsburgh Terminal* should be honored here either because it is correct or binding. Three of the six judges who follow *Pittsburgh Terminal* conclude that the rights recognized in *Pittsburgh Terminal* are assignable only if there is an express provision to that effect. Because there was no express assignment here, these judges argue that appellants may not now assert their transferors' rights. The remaining three judges are of the view that the cause of action was automatically assigned to appellants as purchasers. These three members of the court would reverse the dismissal of the federal claims.

As to appellants' state law claims we vacate the judgment of the district court and remand with a direction that the district court consider whether appellants can maintain this part of their class action suit as a diversity action. The district court dismissed without explaining whether the jurisdictional requirements of 28 U.S.C. § 1332 were met under *Zahn v. International Paper Co.*, 414 U.S. 291 (1973). The district court may also wish to consider the possibility of state claims under pendent jurisdiction asserted by other litigants.

Accordingly, the judgment of the district court dismissing the federal claims of appellants will be affirmed. As to appellants' state law claims, the district court judgment will be vacated and remanded for further proceedings consistent with this opinion.

Each side to pay its own costs.

Lowry v. The Baltimore and Ohio Railroad Company, et al.
No. 81-1976

GARTH, *Circuit Judge*, concurring in the judgment, with whom SLOVITER, *Circuit Judge*, joins:

I.

In *Pittsburgh Terminal Corp. v. Baltimore & O. R.R.*, 680 F.2d 933 (3d Cir.), *cert. denied*, 103 S. Ct. 475-76 (1982), a panel of this court held that Rule 10b-17, 17 C.F.R. §240.10b-17 (1982), required notice to holders of convertible debentures of a dividend declared by B & O on December 13, 1977.¹ However, the panel was divided in its vote on *Lowry*, argued and considered by the panel with *Pittsburgh*, to the extent that no judgment could be entered. This in turn led to a recommendation that the full court sitting *in banc* entertain *Lowry's* appeal. The primary issues that divided the *Lowry* panel were: (1) whether federal law or state law controlled; and (2) if federal law controlled, what was the content of that law. In order to focus the parties' attentions on the concerns of the court, supplemental briefs were sought with respect to the following issues:

1. Upon the sale on the New York Stock Exchange of convertible debentures of the Baltimore and Ohio Railroad Company, does federal or state law govern

1. Although Judge Gibbons predicated the B & O's duty to disclose on other grounds as well, I concurred only as to Rule 10b-17, which constitutes the holding of the case. See *Pittsburgh Terminal Corp. v. Baltimore & O. R.R.*, 680 F.2d 933, 943-46 (3d Cir.) (Garth, J., concurring in part and concurring in the judgment), *cert. denied*, 103 S. Ct. 475-76 (1982). Because the court denied a petition for rehearing in *Pittsburgh*, this court was on record at the time of our *in banc* consideration of *Lowry* as having held that a federal cause of action inured to the benefit of convertible bondholders who held those bonds on December 13, 1977. Here, of course, the plaintiffs acquired their debentures after that date and after public disclosure of B & O's dividend declaration.

whether accrued causes of action arising under the federal securities laws are automatically assigned to the subsequent purchasers of those debentures?

2. If federal law applies, what is the content of that law?

3. If state law applies, which state's law governs, and what is the content of that law?

4. What law governs the assignability of any accrued common law or state statutory causes of action pleaded in the complaint?

5. If a different law of assignability applies to causes of action arising under federal and state law, what persons will be covered by the stipulation in *Pittsburgh Terminal Corp. v. Baltimore & Ohio R.R. Co.*, Nos. 81-1674/1675, that convertible debenture holders who are not parties will receive any benefits ultimately decided to be due to the individual plaintiffs in that case?

6. If it is concluded that the plaintiffs have no federal cause of action, what disposition should be made of the remainder of the complaint?

The supplemental briefs filed by both of the parties agreed that federal law controlled. Lowry argued that federal law would recognize automatic assignability, while the B & O argued otherwise. At oral argument before this court, in addition to the arguments found in their briefs, B & O argued for the first time that N.Y. Jud. Law §489 (McKinney 1968)² would, in any event,

2. N.Y. Jud. Law §489 (McKinney 1968) provides in pertinent part:

No person or co-partnership, engaged directly or indirectly in the business of collection and adjustment of claims, and no corporation or association, directly or indirectly, itself or by or through its officers, agents or employees, shall solicit, buy or take an assignment of, or be in any manner interested in buying or taking an assignment of a bond, promissory note, bill

prohibit the Lowry plaintiffs from obtaining an assignment of their transferors' causes of action. B & O raised this section 489 argument ostensibly to counteract the reliance by Lowry on *Phelan v. Middle States Oil Corp.*, 154 F.2d 978 (2d Cir. 1946), and N.Y. Gen. Oblig. Law §13-107 (McKinney 1978),³ which Lowry claims permits causes of action to be assigned without an express assignment.⁴

The *per curiam* opinion, which is entitled "Opinion of the Court," curiously makes no mention of the significant issue which divided the panel: *i.e.* whether federal or state law dictates the assignability of the *Pittsburgh* cause of action. Indeed, the *per curiam* opinion, without reference to whether federal or state law controls, re-

NOTE — (Continued)

of exchange, book debt, or other thing in action, or any claim or demand, with the intent and for the purpose of bringing an action or proceeding thereon; . . .

Any corporation or association violating the provisions of this section shall be subject to a fine of not more than five thousand dollars; any person or co-partnership, violating the provisions of this section, and any officer, trustee, director, agent or employee of any person, co-partnership, corporation or association violating this section who, directly or indirectly, engages or assists in such violation, is guilty of a misdemeanor.

3. N.Y. Gen. Oblig. Law §13-107 (McKinney 1978) provides:

1. Unless expressly reserved in writing, a transfer of any bond shall vest in the transferee all claims or demands of the transferor, whether or not such claims or demands are known to exist. . . .

2. As used in this section, "bond" shall mean and include any and all shares and interests in an issue of bonds, notes, debentures or other evidences or indebtedness of individuals, partnerships, associations, or corporations, whether or not secured.

3. [Defining term "indenture."]

4. Because the §489 and §13-107 claims should be presented to the district court in the first instance, I do not address them in this opinion. See Part IV C *infra*.

ports that two members of the court do not reach the issue of assignability; that three members of the court would only recognize assignability if there were an express assignment — which there was not — and that the remaining three members of the court (two judges were recused) would hold that the *Pittsburgh Terminal* cause of action *was* automatically assigned to the *Lowry* plaintiffs as purchasers. Because I believe the issue of whether federal or state law controls is at the core of the *Lowry* litigation, and because, according to the tabulation recited in the per curiam opinion, a majority of the court has not expressed itself on the assignability issue, I am forced to write separately.

II.

Lucile Lowry and Lowry-Zweig Corporation appeal from a summary judgment dismissing their class action complaint against the Baltimore and Ohio Railroad Company (B & O), the Chesapeake & Ohio Railway Company, and Chessie System, Inc. The complaint alleges that the defendants violated section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b) (1976), Rule 10b-5 thereunder, 17 C.F.R. §240.10b-5 (1982), and the common law when the B & O declared a dividend in the stock of Mid-Allegheny Corporation (MAC), a B & O subsidiary, on December 13, 1977, without giving notice to holders of B & O convertible debentures.

Details of the transaction are set forth in our recent opinions in *Pittsburgh Terminal Corp. v. Baltimore & Ohio R.R.*, 680 F.2d 993 (3d Cir.), *cert. denied*, 103 S. Ct. 475-76 (1982), and will not be repeated here, other than to set forth those facts necessary to focus on the issues which this case presents. Essentially, however, the circumstances in which these actions arose were as follows.

The B & O had sought to restructure its operations by transferring its non-rail assets to MAC and then distributing MAC stock to the B & O shareholders in the form of a dividend. One consequence of this arrangement was that the B & O convertible debentures, which previously could have been converted into B & O stock representing both B & O's rail and non-rail assets, became convertible into B & O stock which now represented only B & O's rail assets. The *Lowry* plaintiffs claimed that the value of the conversion option, and hence of the convertible debentures, would thus be reduced, unless the debentureholders could convert in time to qualify for the MAC dividend. The plaintiffs in the *Pittsburgh Terminal* action alleged that by deliberately not giving the B & O convertible debentureholders advance notice of the MAC dividend, the defendants unlawfully deprived them of the opportunity to convert before the record date, December 13, 1977. This in turn deprived the convertible debentureholders of the right to participate in the dividend. A panel of the court held in *Pittsburgh Terminal*, *supra*, the companion case to this action, that the failure to notify convertible debentureholders who held debentures on that date violated Rule 10b-5.

While in *Pittsburgh Terminal*, the plaintiffs were holders of B & O convertible debentures who acquired those securities *prior* to December 13, 1977, and held them on that date, the plaintiffs in the instant case acquired their debentures *after* December 13, 1977, and *after* the public disclosure that B & O had on that date declared a dividend in MAC stock.⁵ The district court

5. Ezra Lowry, president of plaintiff Lowry-Zweig Corp. and husband of plaintiff Lucile Lowry, testified at his deposition that he had his wife purchase approximately \$15,000 worth of B & O convertible debentures in late December, 1977, about a week after learning from his stockbroker that the B & O had declared a dividend in MAC stock on December 13, 1977. He stated that he had his wife purchase the debentures, even though he knew the record date for the MAC dividend had already passed, because he believed

certified the plaintiffs as representatives of a class of persons who purchased their debentures on or after December 13, 1977, or who have converted or will convert their debentures into B & O stock on or after December 13, 1977. The plaintiffs contend that the class was too narrowly structured by the district court in that it did not include any holders of the convertible debentures who acquired them prior to December 13, 1977 and did not convert. The plaintiffs also assert that summary judgment should not have been entered against them.

III.

In their complaint, the plaintiffs sought to represent a class consisting of "[h]olders of Debentures as of the time that final judgment is rendered, and . . . [h]olders of Debentures who have or will have converted them into stock of B&O on or after December 13, 1977 and before final judgment is rendered." Cplt. ¶27, App. at 8-9. In granting the plaintiffs' motion for class certification, the district court defined the class to consist of "persons who purchased their debentures on or after December 13, 1977, or who have or will convert their debentures into B & O stock on or after December 13, 1977." App. at 90. By doing so, it excluded debenture holders at the time of judgment who had acquired their debentures before December 13, 1977 and had not converted them. The plaintiffs assert that it was illogical for the district court to include persons in their class who purchased

that "there was a very good chance that if we bought those debentures, we would have the probability of collecting the value of that dividend declaration." App. at 43. Mr. Lowry testified that he had his wife acquire additional debentures in April, 1978, on the basis of a conversation he had with his stockbroker about the *Pittsburgh Terminal* lawsuit. *Id.* at 46-47. Yet more debentures were purchased in July and September of 1978 in anticipation of a favorable settlement of the *Pittsburgh Terminal* litigation. *Id.* at 49-50.

debentures before December 13, 1977 and subsequently converted them, but to exclude persons who purchased debentures before December 13, 1977 and retained them.

As the defendants note, there was no need for the court to include in the class *any* of the debentureholders who purchased debentures prior to the declaration of the MAC dividend, since the defendants had agreed in the *Pittsburgh Terminal* action to give such persons any benefits ultimately decided to be due to the individual plaintiffs in that case.⁶ See *Pittsburgh Terminal* App. at 493a. Thus, to the extent that any debentureholders were excluded from the *Lowry* class, they suffered no prejudice. As this court stated in *Carter v. Butz*, 479 F.2d 1084, 1089 (3d Cir. 1973), "[w]hile we might well have decided otherwise we conclude that the class action determination was within the range of discretion permitted by [Federal] Rule [of Civil Procedure] 23."

IV.

I turn now to the question whether the plaintiffs, having acquired their convertible debentures after December 13, 1977, the date when the MAC dividend was declared, are in the same position as the *Pittsburgh Terminal* plaintiffs insofar as maintaining an action

6. In his dissent, Judge Gibbons assumes I would hold that "the exercise of the conversion privilege as a matter of federal law destroyed the previously held section 10(b) claim" of class members who purchased debentures *before* December 13, 1977, and converted them *after* that date. Typescript at 9. That assumption is incorrect. On the contrary, although such persons may not properly be represented by the Lowrys (who had purchased their debentures *after* December 13, 1977), they will not be prejudiced by the judgment in this case because they will share in any benefits due the *Pittsburgh Terminal* plaintiffs by reason of the defendants' agreement. See Opinion of Seitz, C.J., concurring and dissenting, typescript at 3 n.1.

against the defendants for securities fraud under Rule 10b-5. The plaintiffs concede that since they purchased their debentures after the MAC dividend declaration on December 13, 1977, it was not they, but their predecessors in ownership, who were allegedly defrauded. Nevertheless, the plaintiffs maintain that the Rule 10b-5 claims associated with the dividend declaration run with the debentures by operation of law, and that they therefore have standing to sue the defendants even without having obtained any express assignment of the cause of action from the former debenture owners.⁷

A.

The first consideration to be addressed is whether this court should look to federal or state law in addressing the plaintiffs' contentions. There appears to be little authority on this point, probably because it has generally been assumed that questions of standing under the federal securities laws must be governed by federal law. All the parties to this action at the panel level apparently found this proposition to be self-evident, and thus did not even address this issue. In their *in banc* briefs, both parties agreed that federal law controlled.

I agree with the parties' original assumption, and their later statements, that questions regarding rights

7. Although express assignments of causes of action under the federal securities laws are effective, see *Western Auto Supply Co. v. Gamble-Skogmo, Inc.*, 348 F.2d 736, 739-41 (8th Cir. 1965), cert. denied, 382 U.S. 987 (1966); *International Ladies' Garment Workers' Union v. Shields & Co.*, 209 F. Supp. 145, 149-50 (S.D.N.Y. 1962); *Mills v. Sarjem Corp.*, 133 F. Supp. 753, 761 (D.N.J. 1955); 3 L. Loss, *Securities Regulation* 1817-19 (2d ed. 1961); 6 *id.* 3937-38 (Supp. 1969), when the plaintiffs (and presumably other class members) acquired their debentures with knowledge that the record date for participation in the MAC distribution had already passed, they did not obtain any express assignment of any causes of action which might have accrued to the sellers as a result of B & O's December 13, 1977 actions.

under the federal securities laws must be decided on the basis of federal, and not state, law. Congress enacted the securities laws to vindicate a federal policy of protecting investors. See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 195 (1976); H.R. Rep. No. 1383, 73d Cong., 2d Sess. 1-5 (1934). It established certain standards of conduct in the securities industry, standards that were to be uniform throughout the nation. In doing so, it supplemented a regulatory regime that had, until then, consisted principally of an assortment of varying state laws. A necessary corollary of this unitary scheme of regulation is that remedies for the breach of duties imposed by the federal laws should be uniform across the nation. I am satisfied, therefore, that we should look to principles of federal law in the furtherance of these federal policies, rather than importing state law principles which vary according to the particular state involved and which are designed to further state goals that may differ from those embodied in the federal acts.⁸

The vast majority of securities transactions today are conducted on regional and national exchanges, often through the facilities of national brokerage firms. These transactions are entered into against a background of pervasive federal regulation. Under these circumstances, it would undoubtedly come as a surprise to many investors if their right to sue for federal securities fraud were to depend upon the law of a state whose role in the transaction had been completely incidental and never even contemplated.

8. This is not to say that state law principles have no role to play in the area of securities regulation. The federal securities laws preserve a parallel system of state regulation and remedies which litigants can invoke in addition to any rights they may (or may not) have under federal law. See, e.g., §28(a) of the Securities Exchange Act of 1934, 15 U.S.C. §78bb(a) (1976). The fact that a parallel system of state remedies exists underscores the propriety of applying federal law principles to actions invoking federal statutory remedies.

Even if securityholders' rights under the federal securities acts came to be recognized as depending in part on state law, confusion and uncertainty would still reign because the determination of *which* state's law governed would turn on the fortuity of where the action was filed and on the choice-of-law principles applied by the forum. The question of assignability conceivably could be governed by the laws of various states, among others: the law of the state where the issuer of the securities was incorporated; the state where the stock exchange on which the securities were traded was located; the state where the purchased security was delivered or paid for; or the state in which the broker who arranged the transaction operated. For example, if a citizen of Ohio sold debentures issued by a Delaware corporation with its principal place of business in Illinois, through a stockbroker in Indiana, who executed the sale on the New York Stock Exchange, to a Kentucky broker on behalf of a purchaser in Tennessee, which state's law would apply? If this Tennessee purchaser brought a class action on behalf of all debenture purchasers, as the plaintiffs in this case have done, would his right to recover differ from other members of the class whose debentures were purchased, for instance, on the Pacific Stock Exchange in Los Angeles?

The Supreme Court has recognized that

the doctrine of [*Erie R.R. v. Tompkins*, 304 U.S. 64 (1938)] is inapplicable to those areas of judicial decision within which the policy of the law is so dominated by the sweep of federal statutes that legal relations which they affect must be deemed governed by federal law having its source in those statutes, rather than by local law. . . . When a federal statute condemns an act as unlawful, the extent and nature of the legal consequences of the condemnation, though left by the statute to judicial determi-

nation, are nevertheless federal questions, the answers to which are to be derived from the statute and the federal policy which it has adopted. To the federal statute and policy, conflicting state law and policy must yield.

Sola Elec. Co. v. Jefferson Elec. Co., 317 U.S. 173, 176 (1942) (citations omitted). In a case analogous to this one, involving a promissory note given to a bank by one of its directors in violation of the National Bank Act, the Court held that federal law, not state law, governed the validity of defenses to payment of the note. *Deitrick v. Greaney*, 309 U.S. 190, 200-01 (1940).

In the area of securities regulation, Judge Friendly noted nearly two decades ago that

significant steps toward the development of a federal common law of corporate responsibility have already been taken by implying causes of action from and filling interstices in laws administered by the SEC. . . . When conduct by an "insider" in the sale or purchase of a listed security is challenged under the general language of Section 10(b) of the Securities Exchange Act or Rule X-10b-5 of the SEC, interstitial supplementation is a matter of federal law. Although in these cases the emphasis was on higher standards of conduct, development of federal law can also protect against extreme or unrealistic requirements imposed by a state. . . . [F]or corporations whose business is of national concern, federal law will insure standards that are high but not too high. . . .

Friendly, *In Praise of Erie — And of the New Federal Common Law*, 39 N.Y.U. L. Rev. 383, 413-14 (1964).

The authority that does exist with respect to the issue presented in this case holds that federal common law, not state statutes or decisional law, governs whether causes of action under the federal securities laws run

with the affected securities and hence are automatically assigned to subsequent purchasers of those securities. 3 L. Loss, *Securities Regulation* 1817 (2d ed. 1961). See *Western Auto Supply Co. v. Gamble-Skogmo, Inc.*, 348 F.2d 736, 739-41 (8th Cir. 1965) ("federal and general common law" governs question of survivability of §16(b) action; state statutes provide "added support" for court's interpretation of federal common law), *cert. denied*, 382 U.S. 987 (1966); *Mills v. Sarjem Corp.*, 133 F. Supp. 753, 761 (D.N.J. 1955) ("In the absence of statutory pronouncement in this regard the federal common law will be applied."); cf. *In re Fine Paper Litigation*, 632 F.2d 1081, 1090 (3d Cir. 1980) (status of assignments under the antitrust laws is a matter of federal law). But cf. *Fund of Funds, Ltd. v. King*, [1976-1977] Fed. Sec. L. Rep. (CCH) ¶95,640 (S.D.N.Y. June 29, 1976) (referring to state law in deciding whether assignment of cause of action was effected).⁹

B.

Having concluded that federal law governs the question whether federal securities law claims run with convertible debentures upon their sale, the content of that federal law must now be determined because the Securities Exchange Act is silent on this issue. Nor has any other federal statute which addresses this question

9. Because federal law, not state law, governs whether claims under the federal securities laws run with a convertible debenture upon its sale, the provisions of N.Y. Gen. Oblig. Law §13-107 (McKinney 1978), vesting in the transferee of a bond all claims of the transferor, are not dispositive of the plaintiffs' standing to assert their federal claims. Moreover, N.Y. Jud. Law §489 (McKinney 1968), see note 2 *supra* (prohibiting assignments by corporations, and persons "engaged directly or indirectly in the business of collection and adjustment of claims," "with the intent and for the purpose of bringing an action or proceeding thereon") appears to dilute the plaintiffs' reliance on N.Y. Gen. Oblig. Law §13-107 (McKinney 1978). That issue, however, has yet to be resolved.

been called to our attention. I suggest that we must therefore look to the federal common law of securities regulation for the answer.

As the plaintiffs acknowledge, there is only meager support in the cases for their theory that defrauded debentureholders automatically assign their causes of action under federal securities law when they sell their debentures. In my opinion, the better view is that the availability of such Rule 10b-5 actions should be limited to those investors who themselves have been defrauded, or who are express assignees of defrauded parties. Such an approach is necessary to ensure that compensation for fraudulent securities dealings inures to those persons who were injured by the fraud, rather than to corporate bounty hunters.

When the B & O refused to notify its convertible debentureholders of the MAC dividend on December 13, 1977, it was the persons holding convertible debentures on that date — not subsequent purchasers of those debentures — who were deprived of the opportunity to obtain the MAC dividend. As a consequence of the dividend declaration, the conversion option of the debentures was diluted, since the debentures, which previously had been convertible into stock representing both rail and non-rail assets, were now convertible into stock representing only rail assets. Thus, in a market in which traders deem the conversion option to be more significant than the income feature of the debentures, it would be expected that after December 13, 1977, the value of the debentures would decline to reflect the dilution of that option. Any sale by the debentureholders under such circumstances could not pass the loss onto a subsequent purchaser as the loss would already have been realized by the original debentureholder when less was received from the sale of the debenture than would have been received in the absence of the MAC dividend declaration. Completing this hypothesis, any subsequent purchasers who knew of the MAC dividend — as

these plaintiffs concededly did, *see* note 5 *supra* — and thus of the lessened value of the debentures, presumably paid for the debentures they bought only their post-dividend worth.¹⁰ In so doing, they could have sustained no loss and thus no injury.

In this light, absent any express assignment of a cause of action to the subsequent purchasers, it would be unjust and inconsistent with the remedial purposes of the securities laws to strip the right to recover from the convertible debentureholders who were actually injured, and grant it instead to subsequent purchasers who sustained no injury or loss from the Rule 10b-5 violation. Chief Judge Lord's discussion of this very point is persuasive:

While a security is of course transferred by its sale, the causes of action belonging to a prior holder do not pass with the transfer of the security. The provisions of the securities acts relied upon here create rights of action on the part of investors who have been harmed by the misconduct of others. Those rights belong to the *persons* who have suffered injury. They do not attach for all eternity to the security itself, to pass forever from the person

10. I recognize that many market factors influence the price of a convertible debenture other than the value of its conversion option. Thus, the record in this case, which reveals that little change took place in the market price of the B & O debentures after December 13, 1977, *see Pittsburgh Terminal App.* at 316a, does not invalidate this analysis, which depends on the significance in general of the value of the conversion option — a significance not lost on the plaintiffs, who brought this suit precisely because of their claim to their full conversion rights. The plaintiffs asserted in their complaint: "Had proper notice been given of the declaration of the [MAC] dividend, Debenture holders would have realized the value thereof, either by converting their Debentures on or prior to the record date so as to obtain the dividend as shareholders of B&O or else by selling their Debentures for an enhanced price reflective of the dividend obtainable by conversion." *Cplt. ¶21, App.* at 8.

who has been harmed to be asserted by others who have not. To adopt plaintiffs' extraordinary theory would be to deprive injured persons of their rights and give their causes of action to one who has suffered no injury himself but who simply has been shrewd or lucky enough to have put his hands on a security that once belonged to a person who was defrauded.

Independent Investor Protective League v. Saunders, 64 F.R.D. 564, 572 (E.D. Pa. 1974).¹¹

Although *Phelan v. Middle States Oil Corp.*, 154 F.2d 978, 999-1002 (2d Cir. 1946), appears to take a different view, that opinion is on balance less convincing than that in *Saunders*. *Phelan* did not involve an action under the federal securities laws, but instead was a receivership case. The court based its decision that the claim there asserted ran with the bonds on the belief that a wrongdoing trustee should not be relieved of liability if a bondholder, unaware of the trustee's malfeasance, sells his bonds. However *Phelan* may be read, in the context of this case, there is no reason why an opportunistic subsequent purchaser, rather than the original injured investor, should serve the role of policing improper corporate conduct.

Since I would hold that under federal law, the Rule 10b-5 action did not run with the debentures, the plaintiffs, as subsequent purchasers, in my view lack standing to assert their claims of federal securities fraud asso-

11. As the court stated in *International Ladies' Garment Workers' Union v. Shields & Co.*, *supra*, 209 F. Supp. at 149:

Of course by a mere assignment of securities the assignee does not acquire any and all rights of action that the assignor may have had against the person from whom he bought. One who has been defrauded by the sale of goods to him of a value less than they would have had if as represented retains the right of action for the amount of his damage unaffected by his parting with the goods.

ciated with the dividend declaration. Accordingly, I would affirm the district court's order which entered summary judgment for the defendants on the plaintiffs' section 10(b) and Rule 10b-5 claims.¹²

C.

In their complaint, in addition to jurisdiction alleged under section 27 of the Securities Exchange Act, 15 U.S.C. §78aa (1976), the plaintiffs also alleged that the district court had diversity jurisdiction over their state law claims against the defendants.¹³ Thus, although I have concluded that the plaintiffs lack standing to assert federal securities law claims because under federal common law, those claims were not automatically assigned to them upon their purchase of the debentures, I cannot overlook the state law claims asserted in their complaint which have yet to be resolved, and which they may have standing to pursue under whatever state law is found to be appropriate considering Pennsylvania choice-of-law rules.¹⁴ See *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487 (1941). As to these state law claims, I recognize that among other outstanding issues are the issues of standing under state law, choice of law, and jurisdic-

12. The foregoing analysis of the plaintiffs' standing would also apply to any cause of action the plaintiffs might assert under §6 of the Securities Exchange Act, 15 U.S.C. §78f (1976), based on the B & O's alleged violation of its listing agreement with the New York Stock Exchange (NYSE). We thus need not decide whether an implied private right of action exists under §6.

13. The complaint asserts that the defendants violated provisions of the indenture governing the debentures, the B & O's listing agreement with the NYSE, the NYSE *Company Manual*, and various NYSE rules and instructions. Cplt. ¶¶15-20, App. at 6-7.

14. See, e.g., note 8 *supra*.

tion¹⁵ which have not been presented on this appeal and which have not been decided by the district court. Under these circumstances, it is inappropriate for us to address them. Moreover, defendants raise for the first time before this court the impact of N.Y. Jud. Law §489 (McKinney 1968). This issue is also inappropriate for our determination. I would therefore leave such questions to be determined by the district court in the event

15. Although this court dismisses the Lowrys' federal claims, those claims were not so insubstantial as to divest the district court of the power to exercise pendent jurisdiction over the state claims. See *Hagans v. Lavine*, 415 U.S. 528, 545-50 (1974); *Gagliardi v. Flint*, 564 F.2d 112, 114 (3d Cir. 1977), *cert. denied*, 438 U.S. 904 (1978). Whether the district court should entertain these pendent state claims is a matter for the court's discretion. See *Lentino v. Fringe Employment Plans, Inc.*, 611 F.2d 474, 478-80 (3d Cir. 1979). Because the district court has jurisdiction over the state claims of those diverse parties satisfying the requisite \$10,000 jurisdictional amount, I would find it somewhat anomalous for the district court to refuse jurisdiction over the pendent claims, all of which arise from a common nucleus of fact. However, that decision is one for the district court to make and I would remit that issue to the district court's discretion in the first instance.

In their briefs before the *in banc* court, the Lowrys argued that those diverse parties with claims of less than \$10,000 could aggregate these claims to satisfy the jurisdictional amount, reasoning that the claims are "to enforce a single title or right in which they have a common and undivided interest." See *Snyder v. Harris*, 394 U.S. 322, 335 (1969); *Broenen v. Beaunit Corp.*, 305 F. Supp. 688, 691-92 (E.D. Wis. 1969). Obviously, the district court need not reach this question unless it declines to exercise pendent jurisdiction over those diverse parties with claims of less than \$10,000. I intimate no view with respect to this argument.

Judge Sloviter does not join in this footnote. Instead, she joins in Part V of Chief Judge Seitz' separate concurring and dissenting opinion and would remand appellants' state law claims as pendent claims without directing the district court to consider whether appellants may maintain those claims in diversity.

the plaintiffs persist in pressing these claims on remand.¹⁶

V.

Accordingly, I would affirm the order of the district court certifying the plaintiff class. I would also affirm the order of May 15, 1981 which granted summary judgment for the defendants, but only insofar as that order pertains to the plaintiffs' federal securities law claims. I would reverse so much of the May 15, 1981 order granting summary judgment to the defendants as pertains to the plaintiffs' state law claims and remand for the further proceedings which I have indicated.¹⁷

ADAMS, *Circuit Judge*, concurring in the judgment.

The Supreme Court in *Chiarella v. United States* declared that liability for non-disclosure of material information under the federal securities laws cannot be enforced absent a duty to speak. 445 U.S. 222, 235 (1980). In *Pittsburgh Terminal Corp. v. Baltimore & Ohio R.R.*, 680 F.2d 933 (3d Cir. 1982), a divided panel

16. The plaintiffs argue that if federal securities law claims still remain with the original debentureholders (since those claims do not run with the debentures), and fraud claims under state law are possessed by the plaintiffs as subsequent purchasers (since such claims, it is alleged, are automatically transferred with the security), the defendants may be subject to double liability: to the original debentureholders under federal law, and to the subsequent purchasers under state law. I do not decide here how such a situation, were it to arise, should be resolved, noting only that "[t]here is no absolute rule of [securities] law precluding double liability." 3 L. Loss, *supra*, at 1474. See *McCandless v. Furland*, 296 U.S. 140, 167 (1935).

17. Therefore, I join in the *per curiam* Opinion of the Court, but only to the extent that the judgment which it announces is consistent with the views I have expressed in this opinion.

of this Court held that Rule 10b-17, 17 C.F.R. §240.10b-17 (1982) established such a duty, and imposed liability on The Baltimore and Ohio Railroad for failure to notify its convertible debenture holders of the Mid-Allegheny Corporation dividend prior to the declaration of that dividend on December 13, 1977. As I explained in dissent, I believe that Rule 10b-17 was promulgated for an entirely different purpose, not intended to deal with the situation presented in *Pittsburgh Terminal*, and thus cannot impose a duty to disclose pending dividends which may affect the value of the conversion feature of convertible debentures. *Pittsburgh Terminal Corp. v. Baltimore & O.R.Co.*, *supra*, 680 F.2d at 953-954.

The *Pittsburgh Terminal* defendants filed a petition for rehearing en banc, which was denied. They subsequently filed a petition for certiorari in the Supreme Court, which was also denied. *B. & O. R.R. Co. v. Pittsburgh Term. Corp.*, 51 U.S.L.W. 3420 (U.S. Nov. 29, 1982). In light of these events, I am now satisfied that the panel's interpretation in *Pittsburgh Terminal* is the law of this Circuit. I continue to believe that the dissent in that case was correct and to hope that this Court or the Supreme Court will eventually reject the majority's analysis. This is, however, not an appropriate situation in which to attempt to vindicate my position, since such an effort could compromise judicial integrity and cause confusion. I therefore reach the question whether the cause of action recognized in that case was automatically assigned to those who purchased the convertible debentures with knowledge of the Mid-Allegheny dividend.

For reasons advanced by Judge Garth, I agree that federal law governs the assignability of causes of action arising under the federal securities laws, and that federal law does not provide for the automatic assignment of such causes of action. The securities laws were enacted to protect investors from the fraudulent manipulation of

the securities markets, not to encourage windfall profits arising out of speculation in lawsuits.

I also agree that it would be inappropriate for this Court to decide at this time whether state law causes of action which may or may not exist were automatically assigned to the Lowry plaintiffs at the time they purchased their B&O convertible debentures. These are issues that should be decided in the first instance by the district court, if it has diversity jurisdiction or if it decides to exercise pendent jurisdiction over those state claims that may be asserted on remand.¹

ALDISERT, J., concurring and dissenting, with whom Judge Hunter joins.

This case has produced a flock of opinions representing diverse and distinct points of view. Chief Judge Seitz and Judges Gibbons, Garth, Sloviter, and Becker are of the view that persons who held convertible debentures of the Baltimore & Ohio Railroad on December 13, 1977 have a cause of action under federal law. Moreover, Chief Judge Seitz and Judges Gibbons and Becker are of the view that this right of action could be automatically assigned to subsequent purchasers. Judges Adams, Garth, and Sloviter, on the other hand, would hold that assignment of the cause of action cannot occur automatically but requires an express agreement which is not present here. The court is unanimous, however, in its decision to remand the case for the purpose of determining what state law rights may be asserted by appellants under either the diversity or pendent jurisdiction of the district court.

1. Cf. *Newark Morning Ledger Co. v. United States*, 539 F.2d 929, 932 (3d Cir. 1976).

I concur in the judgment that no federal cause of action is available to these appellants. I do not meet the question of assignability because I conclude that there is simply no federal cause of action available for assignment, be it automatic or otherwise.

The members of this court who believe that a federal cause of action exists rely on the separate opinions of Judges Gibbons and Garth in the panel decision of *Pittsburgh Terminal Corp. v. Baltimore & Ohio R.R.*, 680 F.2d 933 (3d Cir.), cert. denied, ____ U.S. ____ (51 U.S.L.W. 3420, Nov. 29, 1982). As Judge Garth makes clear in his separate opinion today, however, *Pittsburgh Terminal* holds only that Rule 10b-17 requires that notice be given to holders of convertible debentures when a common stock dividend is declared.¹ Rule 10b-17 provides that:

(a) It shall constitute a "manipulative or deceptive device or contrivance" as used in section 10(b) of the Act for any issuer of a class of securities . . . to fail to give notice in accordance with paragraph (b) of this section of the following actions relating to such class of securities:

(1) A dividend or other distribution in cash or in kind, except an ordinary interest payment on a debt security, but including a dividend or distribution of any security of the same or another issuer: . . .

17 C.F.R. §240.10b-17 (1982)(emphasis added). Thus, if *Pittsburgh Terminal* remains the law of this court, failure to provide this notice gives rise to a federal cause of action for damages.

Because an in banc court is free to review and overrule the decision of a previous panel, United States

1. In his *Pittsburgh Terminal* opinion announcing the judgment of the court, Judge Gibbons predicated B&O's duty to disclose on other grounds as well, but Judge Garth concurred only as to liability under Rule 10b-17. Judge Adams, the third panel member, dissented.

Court of Appeals for the Third Circuit, Internal Operating Procedures ch. VIII, C., this appeal provides an appropriate vehicle to examine the precepts which, up until now, had only been before the *Pittsburgh Terminal* panel. Thus, no barrier prevents us from considering whether those who held debentures as of December 13, 1977 have a federal cause of action. Also, it cannot be argued, consistent with established principles of federal jurisprudence, that last rites were administered to this issue by the Supreme Court's denial of certiorari in *Pittsburgh Terminal*. "For [it is] the well-settled view that denial of certiorari imparts no implication or inference concerning the Court's view of the merits."² *Hughes Tool Co. v. Trans World Airlines, Inc.*, 409 U.S. 363, 366 n.1 (1973)(citing *Maryland v. Baltimore Radio Show*, 338 U.S. 912, 919 (1950)(Frankfurter, J.)).

I find the reasoning supporting the judgment in *Pittsburgh Terminal* unpersuasive. I adopt the rationale contained in the following excerpt from Judge Adams' *Pittsburgh Terminal* dissent and conclude that no federal right of action exists. After determining that B&O had no contractual obligation to provide advance notice to its convertible debenture holders of the common stock dividend, Judge Adams stated that:

Judge Gibbons has concluded that Rule 10b-17 applies to the situation at hand because "B&O is the issuer of the convertible debentures, the MAC distribution is a dividend of a security, and that divi-

2. In *Baltimore Radio Show* Justice Frankfurter stated:

Inasmuch, therefore, as all that a denial of a petition for a writ of certiorari means is that fewer than four members of the Court thought it should be granted, this Court has rigorously insisted that such a denial carries with it no implication whatever regarding the Court's views on the merits of a case which it has declined to review. The Court has said this again and again; again and again the admonition has to be repeated.

338 U.S. at 919.

dend related to the convertible debentures since it was material to a decision about exercising the conversion option." At 941. Judge Garth, concurring exclusively on this ground, stresses that, in his view, "a dividend 'relates to' a security if the declaration of that dividend makes the security significantly more or less valuable. . . ." At 945. Because the B&O debentures were of considerably less value after the declaration of the MAC dividend, Judge Garth has concluded that the declaration of the dividend "is an action which clearly 'relates to' " that class of securities.

. . . [T]hese considerations are not sufficient to establish that the dividend declaration "related to" the class of debenture securities as that term is used in Rule 10b-17. Put simply, Rule 10b-17 never was meant to deal with a situation similar to that before us today.

Nothing in the Commission's "Notice of Proposed Rule Making" or in the language of the rule itself suggests that Rule 10b-17 was intended to override the common law and accord debenture holders significant additional *substantive* rights. When the Rule was proposed by the Securities Exchange Commission in 1971, it was described as a rule "to require companies whose securities are publicly traded to furnish public investors with timely advance notice of the *right to receive dividend[s] and other rights which accrue to holders of record* of a specified class of securities as of a specialized date ('the record date')." 36 Fed. Reg. 3430 (1971). In other words, the Rule was designed to ensure that purchasers of securities receive all the fruits of the transaction *to which they legally are entitled* — namely, distributions made after the sale but before the change in ownership is reflected in the corporation's record books. . . .

The differences between the scenario depicted by the SEC and the present case could not be more obvious. In the situation described by the SEC, the purchaser — independent of Rule 10b-17 — has accrued the *right* to receive certain benefits. In such a case, the Rule acts simply to assure that these rights will not be impeded because of the inadequacies inherent in corporate bookkeeping. Here, in contrast, the debenture holders have a right to convert their debentures into shares of common stock. That right has not been defeated. Under well-established common law principles, however, they have no right — unless otherwise specified in the debenture — to notice of corporate actions that may affect the value of the conversion option.

Had the debenture holders foreseen the possibility that B&O would spin off its non-rail assets, arguably they may have bargained for — and paid for — the right to advance notice of the event. Despite the well-settled precedent of *Pratt [v. American Bell Telephone Co.]*, 141 Mass. 225, 5 N.E. 307 (1886) and *Parkinson [v. West End St. Ry. Co.]*, 173 Mass. 446, 53 N.E. 891 (1899), however, the B&O indenture did not require such notice to the debenture holders and the price of the debenture presumably reflected this fact. For this Court today — almost thirty years after the drafting of the indenture — to ignore what was set forth as the intent of the parties and fundamentally to alter the terms of the contract is, in my view, not only legally erroneous but improvident.

680 F.2d at 952-54 (footnotes omitted).

There are yet other sound reasons for not meeting the assignability issue. Putting aside considerations that make suspect a gratuitous viewpoint that states, "Were I to meet this issue, I would hold, etc.," I fear that going off on an alternate ground might dilute the expression of

my firmly held conviction that the December 13, 1977 debenture holders had no federal cause of action to assign. It is basic to our federal judicial system that, as to subject matter jurisdiction, the reach of the federal courts shall not exceed their statutory grasp as established by Congress. In determining that grasp, courts should not torture statutory language, legislative history, or agency regulations to fashion a cause of action where none has been expressly or impliedly provided by Congress. While my views on this subject have not always carried this court, *see, e.g., Ash v. Cort*, 496 F.2d 416, 426-29 (3d Cir. 1974) (Aldisert, J., dissenting), they have found a modicum of acceptance elsewhere, *see, e.g., Cort v. Ash*, 422 U.S. 66 (1975).

Accordingly, I reach only the threshold issue, concluding that the original debenture holders have no federal cause of action and, *a fortiori*, neither do their putative assignees.

GIBBONS, *Circuit Judge*, dissenting.

I dissent from the court's judgment for two independent reasons. First, the method by which the court arrived at a judgment is fundamentally inconsistent with sound appellate practice in the courts of appeals and will bring this court into disrepute. Second, even if the announced judgment had been arrived at properly, it is legally wrong.

I.

A. Why We Have In Banc Hearings

In March of 1940 this court by rule adopted a procedure for hearing cases in banc.¹ The court was prompted

1. The original rule is set forth in *Commissioner of Internal Revenue v. Textile Mills Corp.*, 117 F.2d 63, 67 n.4 (3d Cir. 1940), *aff'd*, *Textile Mills Corp. v. Commissioner of Internal Revenue*, 314 U.S. 326 (1941).

to do so by the disedifying spectacle of the Supreme Court having to resolve intra-circuit conflicts among panels of judges in the Court of Appeals of the Fifth Circuit.² Prior to the adoption of our local rule the view had been expressed that such intra-circuit conflicts were the necessary consequence of the fact that in some circuits there were more than three circuit judges, while under the governing statute the court was composed of three of them.³ Judge Biggs wrote:

A court, as distinguished from the quorum of its members whom it may authorize to act in its name, cannot consist of less than the whole number of its members. . . . To hold otherwise is not merely to affirm a plain contradiction in terms, but is also to *destroy the authority of the court* as a court and to open the way to possible confusion and conflict among its personnel and in its procedure and decisions.

117 F.2d at 70 (emphasis supplied). Thus from the outset this court, which first made use of the *in banc* device, did so for the purpose of preventing the erosion of judicial authority which would inevitably arise from separate groups of judges in the same court deciding that they were free to do their own thing. This court's view prevailed in the Supreme Court, which observed:

Certainly, the result reached makes for more effective judicial administration. Conflicts within a circuit will be avoided. Finality of decisions in the circuit courts of appeal will be promoted. Those considerations are especially important in view of the fact that in our federal judicial system these

2. See *Commissioner of Internal Revenue v. Textile Mills Corp.*, 117 F.2d at 70 (referring to *John Hancock Ins. Co. v. Bartels*, 308 U.S. 180 (1939)).

3. *Lang's Estate v. Commissioner of Internal Revenue*, 97 F.2d 867, 869 (9th Cir. 1938).

courts are the courts of last resort in the run of ordinary cases.

Textile Mills Corp. v. Commissioner of Internal Revenue, 314 U.S. 326, 334-5 (1941) (footnote omitted).

In the 1948 Judicial Code the *Textile Mills* holding was ratified by Congress. 28 U.S.C. §46(c) (1976 & Supp. V 1981). The statute was not received enthusiastically in one court, which held that a panel majority could decide not to permit rehearing.⁴ The Supreme Court reversed with directions that the court of appeals establish a procedure governing the exercise of the full court's power to consider suggestions for in banc consideration. *Western Pacific Railroad Corp. v. Western Pacific Railroad Co.*, 345 U.S. 247, 261 (1953). In response to the *Western Pacific* case the present Fed. R. App. P. 35 was prepared. Like the statute, which codified the Court's holding in *Textile Mills*, the rule is directed at Judge Biggs' original concern that anarchy among the judges of a single court would destroy the authority of the court. We have enshrined that purpose in Chapter VIII(C) of our Internal Operating Procedures, which provides:

It is the tradition of this court that reported panel opinions are binding on subsequent panels. Thus, no subsequent panel overrules a published opinion of a previous panel. Court in banc consideration is required to overrule a published opinion of this court.

We order in banc consideration in cases "where consideration by the full court is necessary to secure or maintain uniformity of . . . decisions. . . ." Third Circuit Internal Operating Procedures, ch. VIII B(1) (revised Sept. 1, 1978).

4. *Western Pac. R.R. Corp. v. Western Pac. R. Co.*, 197 F.2d 994, 197 F.2d 1012 (9th Cir. 1952).

B. This Case

The judgment of the court in banc in this case is entirely inconsistent with the fundamental policy behind 28 U.S.C. §46(c) and Federal Rule of Appellate Procedure 35. Instead of securing or maintaining the integrity of circuit doctrine, the in banc device has in this instance been used in a manner so inconsistent with that purpose that Judge Biggs must be turning in his grave.

1. *Prior Proceedings*

Lucille Lowry and Lowry-Zweig Corp. (the Lowrys) are before us on appeal from a summary judgment dismissing their class action complaint against the Baltimore and Ohio Railroad Company (B & O), the Chesapeake & Ohio Railway Company (C & O), and Chessie System, Inc. (Chessie). The suit complains of the action of B & O in declaring a dividend in the stock of Mid-Allegheny Corporation (MAC), a B & O subsidiary, on December 13, 1977, without giving notice to holders of B & O convertible debentures. It was filed on October 22, 1979. On that date a prior suit, *Pittsburgh Terminal Corp. v. Baltimore & Ohio R.R. Co.*, was already on file challenging the same stock dividend.

In the *Pittsburgh Terminal* case the plaintiffs, holders of B & O convertible debentures, sought class action certification, which was denied as a result of an agreement between B & O and the Indenture Trustee that should plaintiffs prevail all debenture holders similarly situated would be accorded the treatment required by any judgment in plaintiffs' favor.⁵ The *Lowry* complaint was referred to the same trial judge. In the *Lowry* case, however, on April 7, 1980, he entered a Rule 23 class action order designating the Lowry plaintiffs as represen-

5. *Pittsburgh Terminal v. Baltimore & Ohio R. Co.*, 509 F. Supp. 1002, 1009 (W.D. Pa. 1981).

tatives of two separate classes: (1) persons who purchased B & O convertible debentures on or after December 13, 1977, and (2) persons who converted their debentures into B & O stock on or after December 13, 1977. The record before us in *Lowry* does not disclose the precise terms of the agreement between the Indenture Trustees and B & O. Thus we cannot tell whether either class represented by the Lowrys is within its terms. What we can tell, however, is that the Lowry plaintiffs represent a class including debenture holders who acquired their debentures after December 13, 1977, and debenture holders who acquired them before that date but converted them later. Motions to modify the class, and to consolidate the *Lowry* case with the *Pittsburgh Terminal* case for trial were denied on June 16, 1980.

Pittsburgh Terminal went to trial. It resulted in a judgment in favor of the defendants on all counts. On appeal this court reversed, holding that, on the facts found in the district court with respect to the December 13, 1977 transaction, that transaction was a violation of section 10(b) of the Securities Act of 1934, 15 U.S.C. §78j(b) (1976). We remanded to the district court for a determination of appropriate relief. *Pittsburgh Terminal Corporation v. Baltimore and Ohio R.R. Co.*, 680 F.2d 933, 943 (3d Cir. 1982). On June 22, 1982 this court denied a petition for rehearing in *Pittsburgh Terminal*, and on November 29, 1982, the Supreme Court denied a petition for certiorari. *B & O R.R. Co. v. Pittsburgh Terminal Corp.*, 103 S. Ct. 476 (1982). Thus the *Pittsburgh Terminal* case has now been returned to the district court for determination of appropriate relief, which will of necessity require a determination of which class members are to receive the benefit of the agreement between the Indenture Trustee and the B & O.

After the *Pittsburgh Terminal* case was tried and dismissed the defendants moved for summary judgment in the *Lowry* case. That motion was granted for the same reasons relied upon by the trial court in dismissing the *Pittsburgh Terminal* complaint. The *Lowry* plaintiffs appealed, on their own behalf and on behalf of the two classes they represent. They represent one class of purchasers whose bonds were acquired after the December 13, 1977 transaction was a matter of public information. They represent another class — bondholders who converted after that date. The latter class includes purchasers who acquired their bonds before December 13, 1977 and converted after that date, as well as bondholders who both acquired and converted after that date. Moreover their complaint relies not only on section 10(b) but also on certain state law claims asserted both pendent to the section 10(b) claim and on the basis of diversity of citizenship. At least one Lowry appellant satisfies the jurisdictional amount requirement of 28 U.S.C. §1332 (1976). That diversity claimant is an adequate class representative of all class members satisfying jurisdictional amount who could derive benefit from a decree based on state law, including class members who are not diverse. *Supreme Tribe of Ben-Hur v. Cauble*, 255 U.S. 356 (1921). A decision against the Lowry plaintiffs on the section 10(b) claims will bind all class members of the two classes defined in the April 7, 1981 order. Thus the *Lowry* appeal presents a number of discrete legal issues including:

1. whether assignees of a section 10(b) claim may assert it;
2. whether such claims are assigned by operation of law upon sale of a security;
3. whether assignees of state law claims may assert those claims;
4. whether such claims are assigned by operation of law upon sale of a security;

5. whether holders of debentures who are owners of section 10(b) claims and state law claims lose that status when, with knowledge of those claims, they exercise a conversion privilege.

Those issues are entirely apart from the grounds upon which summary judgment was entered.

2. The In Banc Ruling

The panel to which the *Lowry* appeal was assigned was unable to agree on a judgment. That necessitated action by the full court, which, because of recusals, is in this instance comprised of eight members. Three of the eight disagree with the judgment in *Pittsburgh Terminal*, which is now final. Five of the eight conclude that the *Pittsburgh Terminal* case was correctly decided. Two of those five and one of the three conclude that federal law requires an express assignment of a section 10(b) claim, and would affirm on that ground the dismissal of the *Lowry* class action, even though one class includes persons who acquired their securities prior to December 13, 1977 and converted thereafter. Implicitly, but without discussion, those three judges must assume, therefore, that the exercise of the conversion privilege as a matter of federal law destroyed the previously held section 10(b) claim. Three of the five judges who agree with the *Pittsburgh Terminal* ruling also agree that an express assignment of a section 10(b) claim is unnecessary, and that conversion of debentures did not destroy that claim. Two of the three judges who disagree with the *Pittsburgh Terminal* holding refuse to vote on the assignment and conversion issues. Thus, the opinion announcing the judgment of the court rests upon separate minority positions: two votes against the *Pittsburgh Terminal* holding and three votes on assignment and conversion. By withholding their votes on assignment and conversion two judges who disagree with *Pittsburgh Terminal* purport to achieve the result that a

judgment can be entered resting upon separate minority viewpoints upon the governing law. It is true, of course, that there is no clear majority with respect to the assignment and conversion issues. The litigants, however, will certainly be left with the reasonable suspicion that the two judges who have withheld their votes on those issues do not agree that they would support an affirmance.

3. The Judgment is Legally Unsupportable

There are two independent reasons why the two judges who disagree with the *Pittsburgh Terminal* holding may not in this case attempt to support a judgment based upon that disagreement, and thus why the judgment based on concurrent minority views may not stand.⁶

The first reason is that the judgment against the defendants in the *Pittsburgh Terminal* case on liability for a section 10(b) violation is final. That was not the case when the case was argued to the full court on November 8, 1982, since, although we had already denied a petition for rehearing, there was a petition for certiorari pending. When that petition was denied on November 30, 1982, before the entry of our judgment, however, the *Pittsburgh Terminal* liability judgment against the defendants became final for all purposes. With that final judgment extant the defendants are collaterally estopped from contending in this court or any other forum that they are not liable for a section 10(b) violation. All class members, whoever they may be, are protected against relitigation of the issues determined in the *Pittsburgh Terminal* case, even though not formally parties to that case. *Allen v. McCurry*, 449 U.S. 90 (1980); *Parklane Hosiery Co. v. Shore*, 439 U.S. 322 (1978); *Blonder-Tongue Laboratories, Inc. v. University of Illi-*

6. Judge Adams dissented in the *Pittsburgh Terminal* case, but concedes that he is now bound by its holding.

nois Foundation, 402 U.S. 313 (1971); *Katz v. Carte Blanche Corporation*, 496 F.2d 747, 759 (3d Cir. 1974); *Bruszeuski v. United States*, 181 F.2d 419 (3d Cir.), cert. denied, 340 U.S. 865 (1950); *Pentland v. Dravo Corp.*, 152 F.2d 851, 856 (3d Cir. 1945). The three judges who disagree with the *Pittsburgh Terminal* holding are simply not free to act on that disagreement in support of a judgment in favor of the defendants, because that ground of appeal is no longer available to the defendants.

The second reason is that even if the defendants were not collaterally estopped, the *Pittsburgh Terminal* opinion is a binding precedent which the three judges who disagree must follow until a majority of a court in banc chooses to overrule it. Judge Aldisert contends that because this case is before the court in banc each judge is free to disregard prior precedent. I agree that the court in banc is free to reconsider a prior precedent. But a court in banc can only act by majority vote. Taking the position that each member of a court in banc is free to do his or her own thing disregards the very purpose of the in banc rule. It reintroduces the very anarchical principle that Judge Biggs recognized when our original rule was drafted. The anarchism is compounded of withholding votes on the dispositive issues in the case so that a combination of minority positions can achieve a result. Judge Aldisert justifies this practice on the ground that "going off on an alternate ground might dilute the expression of [his] firmly held conviction that the December 13, 1977 debenture holders had no federal cause of action to assign." Typescript at 6. That is the very willful disregard of precedent that concerned Judge Biggs when the in banc rule was first adopted by this court, and its exercise in an in banc court is even more likely, in his words, to destroy the authority of the court.

The unseemliness of the position taken by the judges willing to announce a judgment resting on two legal propositions, neither of which commands a majority, can be fully appreciated by considering the dilemma which the district court will face on remand in *Pittsburgh Terminal*. As noted above, there is an agreement with the Indenture Trustee that all bondholders similarly situated with the *Pittsburgh Terminal* plaintiffs will receive the benefit of the judgment. Inevitably the district court will be required to determine who are the beneficiaries of that agreement. The irresponsibility of this court in the instant case will make that task a nightmare. Looking at our decision, the district court will know that since only three judges take a stand against automatic assignment of section 10(b) claims, members of the class of post-December 13, 1977 bond purchasers cannot be collaterally estopped from claiming to be protected by the agreement. At the same time, since only three judges take a stand in favor of automatic assignment on sale, the court will be left in the unenviable position of guessing what the law of the circuit is. Were the question to be presented to me, the best I could do would be to guess that the silent brothers probably agree that assignment was automatic, or else they would have relied on that ground in order to affirm. The district court's dilemma is even more acute with respect to class members who bought bonds before December 13, 1977 and exercised a conversion privilege thereafter, for with respect to them only three judges have actually announced a position. Does the silence of five mean that those class members are collaterally estopped?

The difficulties which the district court will face on remand in *Pittsburgh Terminal* make it certain that the issues which divide the court in this in banc proceeding will be back before a panel of the court in the not too distant future. When that happens, if I am a member of the

panel I will take the position that this decision has no binding effect as a precedent because it decides nothing, and that it has no collateral estoppel effect, even against the class members represented by the Lowrys, because the basis of the judgment is wholly indeterminate. Indeed, I would regard any effort to apply *res judicata* effect to a class action judgment predicated upon the concurrence of two legal propositions, neither of which commands a majority in the court which announced the judgment, to be a violation of due process of law. Thus in my view the district court will be free, in fashioning relief on remand in *Pittsburgh Terminal*, to disregard the non-decision in this case, and make an independent determination as to who should benefit from the agreement with the Indenture Trustee.

The one thing the district court may not do, however, two judges of this court to the contrary notwithstanding, is disregard *Pittsburgh Terminal* either as a judgment establishing defendants' liability or as a binding precedent. Both the district courts in this circuit and future panels of this court are bound by that precedent. Even if the two judges who chose to vote against the *Pittsburgh Terminal* holding today were to comprise a majority of a panel to which the issue were presented tomorrow, they would be bound by it. Thus this court's willingness to enter a judgment based on two propositions neither of which commands a majority has accomplished nothing except to bring its appellate process into disrepute.

II.

The unfortunate inconclusive judgment in this case rests in part upon the view of three judges that as a matter of federal law an express assignment is required for the transfer of a section 10(b) claim. That issue involves not one question but two.

The first question is whether section 10(b) claims are assignable at all. It has been held repeatedly that they are. *E.g. Western Auto Supply Co. v. Gamble-Skogmo, Inc.*, 348 F.2d 736, 739-41 (8th Cir. 1965), *cert. denied*, 382 U.S. 987 (1966); *International Ladies Garment Workers Union v. Shields & Co.*, 209 F. Supp. 145, 149-50 (S.D.N.Y. 1962); *Mills v. Sarjem Corp.*, 133 F. Supp. 753, 761 (D.N.J. 1955). In the *Mills* case Judge Forman rejected the contention that actions for damages under the federal securities law were penal, and for that reason should not be considered assignable. The question whether a section 10(b) claim, or indeed any interest created by federal law, is assignable is in my view undoubtedly a federal law question. Obviously, it would be intolerable to permit the states to determine the transferability, and thus the value, of interests created by federal law. Moreover those cases holding that section 10(b) claims are freely transferable announce the proper federal rule. Any other rule would be inconsistent with the underlying policy behind that federal statute: the protection of security holders from manipulative or deceptive acts or practices. When such acts or practices have occurred litigation seeking a remedy is often protracted and expensive. Not all victims are so positioned that they can stand either the delay or the expense. Thus they should be able to sell their securities, and the cause of action, in the marketplace at a price which reflects the market's consideration of the value of the claim. Any other rule would compound the injury to the victim by requiring that he await the outcome of a lawsuit before realizing something of what has been taken by the wrongdoer.

The second question is whether or not an assignment has occurred. This in turn involves three sub-issues. The first is whether state or federal law decides the fact of assignment. The second is whether, assuming federal law applies, in the absence of a statute

the federal common law demands a single uniform rule or looks in each instance to the law of the state where the transaction occurred. The third is whether, assuming a federal uniform rule is required, the court should examine the laws of the states to determine what the national consensus is. Each of these issues requires a separate analysis.

There is certainly no clear consensus that federal law decides the fact of assignment of interests created by federal law. Indeed the general rule has long been assumed to be otherwise. *E.g. Miree v. DeKalb County*, 433 U.S. 25 (1977) (state law determines standing as third party beneficiary of federal contract); *Wallis v. Pan American Petroleum Corp.*, 384 U.S. 63 (1966) (validity of transfer of federal oil and gas lease determined by state law although federal statute made lease assignable); *Bank of America National Trust & Savings Association v. Parnell*, 352 U.S. 29 (1956) (state law determines rights on transfer among private parties of commercial paper of the United States); *DeSylva v. Ballentine*, 351 U.S. 570 (1950) (ownership of copyright on death of author determined by state law); *Becher v. Contoure Laboratories*, 279 U.S. 388 (1929) (constructive trust of patent for invention determined by state law); *New Marshall Engine Company v. Marshall Engine Company*, 223 U.S. 473 (1912) (assignment of patent for invention decided by state law); *Joy v. St. Louis*, 201 U.S. 332 (1906) (assignment of federal land patent decided by state law); *Shoshone Mining Company v. Rutter*, 177 U.S. 505 (1900) (assignment of federal mineral patent decided by state law); *Blackburn v. Portland Gold Mining Company*, 175 U.S. 571 (1900) (claim to mining patent determined by laws of mining district in which land situated). These decisions reflect the patent reality that so long as an interest created by federal law is in fact transferable the national government no longer has any obvious interest in who owns it or what formali-

ties were involved in its transfer. Transferability of property, no matter what law creates the property interest, is a matter of traditional state law of contract. Before the general rule that state law determines the transferability of interests created by federal law may be displaced, some palpable federal interest in doing so must be identified. There is nothing about a section 10(b) claim that distinguishes it in this respect from federal commercial paper, patents, copyrights, or land grants.

Assuming, *arguendo*, however, that the fact of assignment should be recognized as one of federal common law, one must pass next to the question whether that common-law rule should not adopt the law of the place where the transaction occurred, so long as it does not impede the underlying federal policy. Early post-*Erie* efforts of the Supreme Court to develop federal common law rules were tellingly criticized for passing too quickly from the first to the second question. *See* Friendly, "In Praise of *Erie* — And of the New Federal Common Law," 39 N.Y.U. L. Rev. 383, 410 (1964) (*Clearfield Trust* compressed consideration of issue of need for federal common-law rule and issue of choice of such a rule). Sensitive, perhaps, to that criticism, the Court now requires a more thorough examination of the choice of law problem. *United States v. Kimbell Foods, Inc.*, 440 U.S. 715 (1979). In the *Kimbell Foods* case the issue was priority of liens stemming from federal lending programs managed by the Small Business Administration and the Federal Housing Administration. Pointing to *Clearfield Trust v. United States*, 318 U.S. 363 (1943), the Court held that because those agencies derive their authority to effect the loans in question from federal statutes, their rights are derived from federal law. 440 U.S. at 726. But that did not require resort to uniform federal rules, for

[w]hether to adopt state law or to fashion a nationwide federal rule is a matter of judicial policy "de-

pendent upon a variety of considerations always relevant to the nature of the specific governmental interests and to the effect upon them of applying state law." *United States v. Standard Oil Co.*, 332 U.S. 301, 310 (1947).

Undoubtedly, federal programs that "by their nature are and must be uniform in character throughout the Nation" necessitate formulation of controlling federal rules. . . . Conversely, when there is little need for a nationally uniform body of law, state law may be incorporated as the federal rule of decision. Apart from considerations of uniformity, we must also determine whether application of state law would frustrate specific objectives of the federal programs. If so, we must fashion special rules solicitous of those federal interests. Finally, our choice-of-law inquiry must consider the extent to which application of a federal rule would disrupt commercial relationships predicated on state law.

Id. at 728-29 (footnotes and citations omitted). Making this fairly complex interest analysis, the Court in *Kimbell Foods* unanimously held that the relative priority of private liens and consensual liens arising from government lending programs would be determined under nondiscriminatory state laws. If an interest analysis with respect to incorporation of federal law is required even when the government's own property interest are involved, *a fortiori* such an analysis is required before we reject state law respecting the assignability of privately-owned claims.

Addressing the question whether application of state law would frustrate the specific objectives of the federal program requires an identification of those objectives. With respect to section 10(b), the objective is to protect the interstate market in securities from manipu-

lative and deceitful practices which once were tolerated under some state law. That objective is achieved so long as (1) someone owns the section 10(b) cause of action, and (2) the victim can freely transfer it to a party who can afford to await the results of a lawsuit. That exhausts the federal government's interests, so long as information about the claim is equally available to the victim and the assignee. Section 10(b) presumes a market in which traders have equal access to information, and no special duty of disclosure can be implied from it or any other provision of federal law which would require an outsider assignee to volunteer information.

Turning to the question whether a federal rule would disrupt commercial relationships, we must start with the proposition that the overwhelming mass of securities transfers takes place in the two great securities exchanges in New York City, and in that city's over-the-counter market. Buyers and sellers almost never see each other. Thus, imposing a requirement that there be an express assignment of a section 10(b) claim for all practical purposes makes such claims unassignable. The effect of making them for practical purposes unassignable will be that the marketplace cannot take into account any incremental market value which might have resulted from public information about the existence of the claim. It is true that the seller will retain the claim and can proceed with his own suit or await the outcome of a class action brought by someone else. That will be cold comfort, however, to a holder of a security who wants, and perhaps even needs, to sell it. Some investors can afford to speculate on the incremental market value which may be added to a security as a result of litigation, and can even afford to finance such litigation. The depositions on file disclose that this is precisely what the Lowrys did. For others in more necessitous circumstances the only practical alternative will be to realize in the marketplace what the security

will bring here and now. A rule requiring an express assignment of a section 10(b) or any other federally based claim connected with it, practically impossible of accomplishment in the real world of the securities markets, would have the inevitable effect that the seller cannot realize any increment in the market based on public knowledge of its existence. Once the sale has occurred the seller will have almost no incentive to pursue the claim. An express assignment requirement, therefore, will inure primarily to the benefit of the wrongdoer.

In New York State, where the vast majority of securities transfers takes place, the state has expressly rejected the requirement of an express assignment, in a statute providing:

Unless expressly reserved in writing, a transfer of any bond shall vest in the transferee all claims or demands of the transferor, whether or not such claims or demands are known to exist, (a) for damages or rescission against the obligor on such bond, . . .

N.Y. [General Obligations Law] §13-107 (McKinney 1978). That provision, a part of the title on transfer of obligations and rights of the New York General Obligations Law, was recommended by the New York Law Revision Commission to change the rule of *Smith v. Continental Bank & Trust Co.*, 292 N.Y. 275, 54 N.E.2d 823 (1944), that absent an express assignment of accrued causes of action for breach of fiduciary duties, such causes of action do not pass to the transferee of a corporate bond. It adopts precisely the opposite rule, advocated by Judge Jerome Frank in *Phelan v. Middle States Oil Corp.*, 154 F.2d 978 (2d Cir. 1946), that unless the seller of a bond expressly reserves accrued causes of action they pass with the transfer of the bond. See *Recommendation of the Law Revision Commission to the Legislature Relating to the Transfer With Bonds*

of *Claims Connected Therewith*, Dec. 14, 1949, 9 Leg. Doc. No. 65(D), reprinted in New York State Law Revision Commission Report, Recommendations and Studies, at 25-47 (1950). Parties to a sale can agree otherwise, but when they do not memorialize a different intention, the statute fills in the gap in the transaction.

One effect of the change in New York law with respect to how transfer of accrued causes of action respecting bonds must be evidenced was to make the rule on bond transfers consistent with that respecting stock transfers. See N.Y. [Personal Property Law] §168, repealed by U.C.C. §10-102, eff. Sept. 27, 1964 (McKinney 1976) (repealed N.Y. version of the Uniform Stock Transfer Act, Section 7). The Uniform Commercial Code now deals with investment securities generally. It provides that "[u]pon delivery of a security the purchaser acquires the rights in the security which his transferor had or had actual authority to convey. . . ." N.Y. [Uniform Commercial Code Law] §8-301 (McKinney 1964). Thus the Uniform Commercial Code and the New York General Obligations Law are consistent.⁷

The Uniform Commercial Code and the New York General Obligations Law reflect the judgment of the commercial world that marketability of securities will best be encouraged by a rule that upon transfer all increments of market value travel with the security unless ex-

7. The claims being asserted are not derivative shareholder actions. Thus the special rule as to such claims in Fed. R. Civ. P. 23.1, requiring that the plaintiff be a shareholder at the time of the action complained of, has no application. Compare W. Fletcher, *Cyclopedia of the Law of Private Corporations*, §§5980-81 (rev. perm. ed. 1980) (discussing state and federal rules concerning stockholders' derivative suits) with *id.* §5936.1 (discussing decisions holding that shareholder maintaining nonderivative action is not required to own stock at time of events complained of).

pressly reserved. Carving out an exception for increments of market value resulting from public information about actual or potential section 10(b) claims will seriously interfere with commercial relationships in that marketplace.

That observation suggests the plain answer to the third question. Assuming the need for a uniform federal common-law rule about assignability of section 10(b) claims, what considerations would prompt the adoption of any rule other than that embodied in the New York General Obligations Law and the investment security transfer provision of the Uniform Commercial Code? The three judges who espouse a requirement of an express assignment mention the possibility of lack of uniformity, but it is their proposed rule which introduces lack of uniformity. The Uniform Commercial Code governs in any place where a market for investment securities is likely to exist. If a federal common-law rule is deemed appropriate to prevent the application of different rules elsewhere, it is the rule of the New York General Obligations Law and the Uniform Commercial Code which obviously should be adopted. *See New York, N.H. & H. R.R. v. Reconstruction Finance Corporation*, 180 F.2d 241 (2d Cir. 1950), *noted in* 64 Harv. L. Rev. 342 (1950) (Negotiable Instruments Law a source of federal common law).

There are, moreover, overriding federal concerns which militate strongly against separating ownership of the federal law and state law claims attaching to an investment security. The federal courts have exclusive jurisdiction over claims predicated on section 10(b). 15 U.S.C. §78aa (1976). Such claims are frequently filed, as in this case, as class actions. The federal courts have a significant interest in the expeditious settlement of those claims. State law claims arising out of the transaction complained of must as a matter of practical necessi-

ty be filed as pendent claims so that they, too, can be disposed of in any settlement or litigated decree. A rule which for all practical purposes subdivides the ownership of claims in connection with investment securities along federal/state lines would make the settlement of class actions infinitely more difficult. Damages for state common-law fraud and for manipulative and deceptive acts and practices under section 10(b) will be largely identical, but different classes will be able to recover. The three judges who suggest that ownership should be subdivided in this manner observe with apparent equanimity that there is no absolute rule precluding double liability. Typescript, Judge Garth's opinion, at 21 n.16. District judges who have to deal with class action settlements would not greet such a rule with equal equanimity.

Because the weird judgment in this case does not actually rest upon any majority rationale, the district court to which it is remanded will be faced with some difficult issues. We are remanding the state law claims. The defendants will be faced, in defending against those claims, with the collateral estoppel effect of the facts which were found in the *Pittsburgh Terminal* case. It seems highly unlikely that those facts will permit a judgment on all pendent state law claims in favor of the defendants. Thus it is highly likely that the class of bondholders who purchased after December 13, 1977 will prevail. At that point the district court will have to decide whether by virtue of the agreement with the Indenture Trustee the bondholders who sold to that class can also recover, even though they presumably recovered in the marketplace the increment of market value arising from public knowledge of the section 10(b) claim.

Moreover, the judgment affirms dismissal of the claims of bondholders who converted after December 13, 1977, although only this opinion and a footnote in

Judge Garth's opinion mention that class. They, too, will have state common-law claims. If they prevail, however, the defendants will only have to pay once.

III.

The entry of a judgment based on two legal propositions, neither of which commands a majority, is a disgrace to the judicial process. The scandal is compounded by the fact that two judges have voted to rest the judgment on grounds which the defendants are collaterally estopped from asserting. The other non-majority position, that a different rule of assignability applies to the assignment of federal and state claims incident to ownership of an investment security, is fundamentally unsound. The same rule of automatic assignment absent express reservation applies to all legal claims, federal or state, which are incidents of ownership of the transferred securities. Thus the only proper judgment in this case is an outright reversal and remand on all claims.

SEITZ, *Chief Judge*, with whom BECKER, *Circuit Judge*, joins, concurring and dissenting.

I concur in the judgment of the court insofar as it vacates the district court's dismissal of appellants' state law claims and remands those claims for further proceedings. I dissent from that part of the court's judgment that affirms the dismissal of appellants' claim under section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b).

I.

This appeal comes to us from a grant of summary judgment in favor of appellees. Summary judgment was based on the district court's decision in *Pittsburgh Ter-*

minal Corp. v. Baltimore & Ohio R.R., 509 F. Supp. 1002 (W.D. Pa. 1981). Plaintiffs in *Pittsburgh Terminal* held convertible debentures of the Baltimore & Ohio Railroad [B & O] on December 13, 1977. They alleged that B & O's failure to provide advance notice to its convertible debentureholders of a December 13, 1977 dividend of Mid-Alleghany Corporation [MAC] to B & O's common stockholders violated Rule 10b-5, 17 C.F.R. §240.10b-5 (1982). The district court held in *Pittsburgh Terminal* that B & O's failure to provide advance notice of the December 13, 1977 dividend did not violate Rule 10b-5.

The Lowrys, class representatives in this case, purchased B & O convertible debentures after December 13, 1977. They claim that they hold their sellers' claims by assignment. The Lowrys brought a class action against appellees under section 10(b) based on the same conduct that underlay the 10(b) claim in *Pittsburgh Terminal*.

Before *Pittsburgh Terminal* was resolved by bench trial, appellees moved for summary judgment in this case on two grounds: first, the Lowrys purchased after December 13, 1977 and thus lacked standing to assert any 10(b) claim arising out of B & O's failure to provide advance notice of the MAC dividend; and, second, appellants were barred from asserting any such claim by the one year statute of limitations under Pennsylvania's Blue Sky Law, Pa. Stat. Ann. tit. 70, §1-504(a) (Purdon Supp. 1982).

The district court denied that motion, rejecting appellees' first argument and deferring resolution of the second to trial on the merits. In rejecting appellees' first argument, the district court determined that those persons who held convertible debentures on December 13, 1977 held contractual rights to purchase the underlying common stock and thus had standing to assert a 10(b) claim under the rule of *Birnbaum v. Newport Steel Corp.*, 193 F. 2d 461 (2d Cir.), cert. denied, 343 U.S. 956

(1952). See *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 751 (1975) (recognizing that "the holders of puts, calls, options and other contractual rights or duties to purchase or sell securities have been recognized as 'purchasers' or 'sellers' of securities for purposes of Rule 10b-5").

The district court's class certification in this case included within the class both those persons who had purchased debentures before December 13, 1977 and had converted after that date and those who, like the Lowrys, had purchased after December 13, 1977.¹ However, in rejecting appellees' standing argument, the district court did not determine whether the Lowrys, and other class members who had purchased after December 13, 1977, [Lowrys] had been assigned the 10(b) claims of their sellers, nor whether they could assert those claims as assignees.

After a bench trial, the district court held in *Pittsburgh Terminal* that B & O's failure to make a timely disclosure of its December 13, 1977 dividend had not been accompanied by the scienter required under Rule 10b-5 and dismissed the case. Whereupon, appellees in the present case made a second motion for summary judgment. They argued that because appellants' 10(b) claim in this case was predicated on the same failure to disclose as the claim in *Pittsburgh Terminal*, the district court should dismiss appellants' 10(b) claim on the ground that B & O had not acted with the scienter re-

1. *Pittsburgh Terminal* was not a class action, but defendants in that case, appellees here, stipulated that if the plaintiffs prevailed in *Pittsburgh Terminal*, they would provide to all "similarly situated" convertible debentureholders the same relief provided to the named plaintiffs. It seems that all those who held convertible debentures on December 13, 1977 are covered by appellees' stipulation in *Pittsburgh Terminal*. Thus, to the extent that the class certification here includes within the class persons who held on December 13, 1977, it seems to sweep too broadly.

quired by Rule 10b-5. The district court agreed and granted appellees' second motion solely on the basis of its decision in *Pittsburgh Terminal, Lowry v. Baltimore & Ohio R.R.*, No. 79-1504 (W.D. Pa. May 15, 1981).

Plaintiffs in both *Pittsburgh Terminal* and *Lowry* appealed. This court reversed the district court's decision in *Pittsburgh Terminal*, holding that B & O had a duty to provide advance notice to its convertible debentureholders of the MAC dividend and that in failing to make such a disclosure, B & O had acted with the scienter required to support a claim under Rule 10b-5. *Pittsburgh Terminal Corp. v. Baltimore & Ohio R.R.*, 680 F.2d 933 (3d Cir. 1982), *cert. denied*, 51 U.S.L.W. 3420 (U.S. Nov. 29, 1982).

The appeal in this case presents two questions: first, whether a violation of Rule 10b-5 has been established; and, second, whether a claim arising out of any such violation has been automatically assigned to the Lowrys.

II.

I agree with this court's opinion in *Pittsburgh Terminal* that Rule 10b-17, 17 C.F.R. §240.10b-17 (1982), imposed on B & O the duty to give advance notice to its convertible debentureholders of the dividend in MAC stock and that the breach of that duty could support a claim under Rule 10b-5. I also agree that in failing to provide such notice, B & O acted with the scienter required to support a violation of Rule 10b-5. Because I agree with the panel in *Pittsburgh Terminal* that B & O's conduct violated Rule 10b-5, I need not decide whether appellants may also rely on the panel's judgment in *Pittsburgh Terminal* to collaterally estop appellees from relitigating that issue before this court sitting *in banc*.

Rule 10b-17 imposes a duty on the issuer of a publicly traded class of securities to give notice 10 days prior to the record date of any dividend or other distribution

"relating to such class of securities." Although the common stock on which the MAC dividend was declared was not a publicly traded class of securities at the time of the declaration, the convertible debentures were. Thus, the question is whether the MAC dividend related to the convertible debentures within the meaning of the rule. Because the term "related to" is not defined in Rule 10b-17, we must determine its meaning from existing case law under section 10(b).

This court has held that the purchaser of a convertible debenture who purchases relying on material misrepresentations in the equity prospectus may state a claim under section 10(b). *Kusner v. First Pennsylvania Corp.*, 531 F.2d 1234, 1238 (3d Cir. 1976). As *Kusner* recognizes, the value of the conversion privilege is inextricably tied to the value of the underlying common stock. The value of the common stock, in turn, depends largely on the issuer's dividend policy. B & O's convertible debentureholders had a contractual right to purchase B & O common stock at a given price. To exercise their conversion options as informed investors, the bondholders had to know the value of the stock underlying that option. Thus, as both a practical matter and for purposes of section 10(b), I believe that the MAC dividend related to the publicly traded convertible debentures.

I believe that Rule 10b-17 imposed on B & O a duty of timely disclosure the breach of which is, in this case, sufficient to support a claim under Rule 10b-5. Thus, I need not decide whether the Indenture Agreement or B & O's listing agreement with the New York Stock Exchange imposed similar duties.

III.

As discussed above, the district court granted summary judgment in this case on the basis of its decision in *Pittsburgh Terminal* that B & O's conduct did not violate Rule 10(b)-5. I believe, as did the majority of the panel

in *Pittsburgh Terminal*, that the district court's decision in *Pittsburgh Terminal* was incorrect. Thus, I would not affirm the district court's dismissal of appellants' 10(b) claim in this case on that basis. Appellees may nevertheless prevail against the Lowrys if this court determines that the Lowrys do not hold a valid assignment of any 10(b) claim arising out of B & O's failure to provide advance notice of its MAC dividend. I turn now to that issue.

Because the district court held in this case that B & O's failure to provide advance notice did not violate section 10(b), it never reached the question whether any 10(b) claim had been assigned to those who purchased after December 13, 1977. Normally, I would prefer to have the district court address the question of assignment on remand. However, the assignment issue has been fully briefed and argued before this court, and in the interest of judicial economy, I agree that we should resolve that issue now.

Both parties concede that the section 10(b) claim is assignable as a matter of federal law, and both relevant case law and commentary indicate that this is so. See, e.g., *Mills v. Sarjem Corp.*, 133 F. Supp. 753, 761-62 (D.N.J. 1955); 3 Loss, *Securities Regulation* 1817-19 (2d Ed. 1962). The Lowrys did not obtain an express assignment of their sellers' claims. However, they claim that any 10(b) claim that had accrued to their sellers was automatically assigned to them as purchasers of the convertible debentures. If such a claim was not automatically assigned, the Lowrys may not prevail on the 10(b) claim they assert here. For the reasons set forth below, I believe that the 10(b) claim was automatically assigned whether federal or state law controls that issue.

If federal law controlled, it would of course be federal common law, and this court would have to determine its content. The content of federal common law may be supplied either by fashioning a nationwide federal rule

or by adopting state law. *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 728 (1979). If this court determined that a uniform federal rule should supply the content of federal common law in this case, I believe that the rule would provide for automatic assignment of federal securities claims to the purchaser of the underlying security, absent an explicit reservation by the seller.

The primary purpose of section 10(b) and the rules promulgated thereunder is to protect investors from manipulative practices in the securities market and to deter such practices in the first instance. Often investors will sell their securities before any fraud or deception is discovered. They will then have little incentive to keep abreast of developments relating to their former investments and thus may never learn of any fraud or deceit. Assignment of a 10(b) claim places the claim with the person most likely to learn of its existence, thus increasing the remedial purposes of the statute and furthering its deterrence goals.

A rule of automatic assignment increases the transferability of 10(b) claims and is more likely to advance the policies underlying the federal statute than a rule requiring express assignment. Requiring express assignment in the current securities market would drastically inhibit the effective assignability of 10(b) claims. The vast majority of securities transactions takes place in a faceless market where buyers and sellers never meet and may never have the opportunity to negotiate an express assignment. Under a rule of automatic assignment, the claim is transferred on purchase to the party most likely to learn of its existence, again maximizing the prophylactic value of the federal statute.

If federal common law were supplied by adopting state law, or if state law controlled, the law of New York would provide the law in this case. Under that law, the 10(b) claim would be automatically assigned to the purchaser of the convertible debenture absent a contrary

agreement. N.Y. [U.C.C.] Law §8-301 (McKinney 1964)²; N.Y. [Gen. Oblig.] Law §13-107 (McKinney 1978).³

Because I believe that, absent an express reservation, assignment of the 10(b) claim in this case is automatic under either federal or state law, I would hold only that the Lowrys obtained an automatic assignment of the federal claim when they purchased the convertible debentures.⁴ I would save for a subsequent case the question whether assignment of federal securities claims is controlled by federal or state law.⁵

2. Section 8-301 provides

(1) Upon delivery of a security the purchaser acquires the rights in the security which his transferor had or had actual authority to convey. . . .

Under UCC §1-102(3), the seller may expressly reserve any such rights. "The effect of provisions of this Act may be varied by agreement. . . ."

3. Section 13-107 provides

Unless expressly reserved in writing, a transfer of any bond shall vest in the transferee all claims or demands of the transferor, whether or not such claims or demands are known to exist, (a) for damages or rescission against the obligor on such bond, (b) for damages against the trustee or depository under any indenture under which such bond was issued or outstanding, and (c) for damages against any guarantor of the obligation of such obligor, trustee or depository.

4. To the extent that *Independent Investor Protection League v. Saunders*, 64 F.R.D. 564 (E.D. Pa. 1974), holds to the contrary, I believe that it is incorrect.

I would hold only that assignment of the 10(b) claim in this case was automatic. I would not decide here whether such a claim would be automatically assigned to a subsequent purchaser if the seller had brought an action on the claim before the sale and that claim was still pending at the time of the sale.

5. Because I believe that the federal common-law rule of assignment would be the same in this case whether this court adopted state law or fashioned a uniform federal rule, I would not determine here which is preferable. See *United States v. Kimbell Foods, Inc.*, 410 U.S. 715, 727-29 (1979) (articulating the factors to be considered in determining whether to adopt state law or to fashion a nationwide federal rule as the federal common law).

IV.

At oral argument before the in banc court, appellees for the first time raised a New York champerty statute as an affirmative defense to the Lowrys' claim that they held as assignees any claims arising out of B & O's December 13, 1977 conduct. N.Y. [Jud.] Law §489 (McKinney 1968).⁶ The parties agree that if federal law governs the question of assignment, the federal law will adopt and apply state law to determine whether the assignment of the federal claim is champertous. *Martin v. Morgan Drive Away, Inc.*, 665 F.2d 598, 604-05 (5th Cir.), cert. dismissed, 103 S. Ct. 5 (1982) (holding that as a matter of federal law, the federal courts should look to state law to determine whether assignment of a federal antitrust claim is champertous). Thus, the validity of this defense does not depend on whether federal or state law governs the assignment question.

Because I believe that B & O's conduct, under the facts of this case, violated Rule 10b-5 and that the 10(b) claim has been automatically assigned to the Lowrys, I would reverse and remand the district court's dismissal of appellants' 10(b) claim for further proceedings. I would prefer the parameters of the champerty issue to be addressed by the district court in the first instance. Thus, on remand I would have the district court determine, among other things, whether the champerty statute that appellees assert as an affirmative defense against the Lowrys governs the conduct at issue here.

6. That law provides

No person or co-partnership, engaged directly or indirectly in the business of collection and adjustment of claims, and no corporation or association, directly or indirectly . . . shall solicit, buy or take an assignment of . . . a bond, promissory note, bill or change, book debt, or other thing in action, or any claim or demand, with the intent and for the purpose of bringing an action or proceeding thereon. . . .

N.Y. [Jud.] Law §489 (McKinney 1968).

V.

I concur in the judgment of the court insofar as it remands appellants' state law claims. However, because I believe that appellants have stated a valid claim under section 10(b) of the federal securities law, I would remand appellants' state law claims as pendant claims. Because I believe that the district court has pendant jurisdiction over appellants' state law claims, I do not join in that part of the court's judgment directing the district court to consider whether appellants may maintain those claims in diversity.

A True Copy:

Teste:

*Clerk of the United States Court of Appeals
for the Third Circuit*

**IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA**

LUCILE LOWRY, et al

v.

THE BALTIMORE & OHIO RR CO.

Civil Action No. 79-1504

ORDER

AND NOW, to wit, May 15, 1981, for reasons set forth in the accompanying opinion,

IT IS ORDERED that the causes of action set forth in the above-entitled case be and the same hereby are dismissed.

IT IS FURTHER ORDERED that summary judgment be and hereby is entered in favor of the defendants and against the plaintiffs.

s/ William W. Knox

U.S. District Judge

CC:

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The Honorable Richard T. Wentley
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**IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA**

LUCILE LOWRY, et al

v.

THE BALTIMORE & OHIO RR CO.

Civil Action No. 79-1504

Dated: May 15, 1981

**MEMORANDUM GRANTING SUMMARY JUDGMENT IN
FAVOR OF DEFENDANTS**

In this case following decision in the two companion cases on March 10, 1981, adverse to the plaintiffs in Pittsburgh Terminal Corp. v. Baltimore and Ohio Railroad Co., Civil Action No. 77-1455, and Monroe Guttman, et al v. Baltimore and Ohio Railroad Co., et al, Civil Action No. 79-94, the defendant herein filed a motion for summary judgment involving other parties bringing a class action against defendants upon the same set of operative facts.

The court had fixed the motion for summary judgment for argument on June 15, 1981, to determine what should be done with this case.

On May 14, 1981, the court received from the attorneys for the plaintiff a letter (copy of which is attached hereto) stating that there seemed to be no need for briefing and oral argument, that the matter seems ripe for decision and requesting the court to withdraw its scheduling order and decide the motion on the present papers. This was assertedly concurred in by the attorneys for the defendants who had filed a motion for summary judgment on April 29, 1981.

It was asserted that by entering judgment now, this matter could be presented to the circuit at the same time as the other cases.

Under the circumstances, the court is willing to comply and will therefore decide the case on the basis of the decision in the Guttman cases without receiving any further evidence considering all the papers in the cases as submitted for determining defendant's motion for summary judgment.

The court incorporates for reference herein the findings of fact Nos. 1-6 and 8-46. In addition, the court orally finds (No. 7) that Lucile Lowry and Lowry Zweig Corporation, the plaintiffs herein purchased certain B&O convertible debentures of the class at issue in the Guttman cases after the declaration of the dividend on December 13, 1977. We further make the following finding:

(50) Class action: certification was granted April 9, 1980, by order of this court.

The court also incorporates by reference herein conclusions of law 1-9.

In the light of the foregoing, an appropriate order will be entered.

s/ William W. Knox

U.S. District Judge

CC: Counsel of record.

**IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA**

LUCILE LOWRY and LOWRY ZWEIG CORP.

V.

BALTIMORE & OHIO RAILROAD CO.

Civil Action No. 79-1504

ORDER

AND NOW, to wit, June 17, 1980, for reasons set forth in the accompanying memorandum opinion,

IT IS ORDERED that the motion for summary judgment or alternatively motion to dismiss filed in this case by the defendant on April 25, 1980, be and the same hereby is denied.

s/ William W. Knox

U.S. District Judge

CC:

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**IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA**

LUCILLE LOWRY and LOWRY ZWEIG CORP.

V.

BALTIMORE & OHIO RAILROAD CO.

Civil Action No. 79-1504

Dated: June 17, 1980

MEMORANDUM OPINION

The defendant in this case has filed a motion for summary judgment or alternatively to dismiss. The motions are based (1) on the alleged lack of standing of plaintiffs to sue because of there being no sale or purchase and late purchase of the debentures.

In our prior opinion in Pittsburgh Terminal Corporation v. B&O Railroad Company, Civil Action No. 77-1455 involving other debenture holders, we covered the situation of standing to sue at pages 6-10.

The defendant calls to our attention Broad v. Rockwell Internatl Corp., 614 F 2d 418 (5th Cir March 24, 1980). In our previous opinion in Pittsburgh Terminal, we declined to follow the district court in Broad v. Rockwell International, but rather chose to follow the language in Blue Chips v. Manor Drug Stores, 421 US 723 (1975) and the holding of Judge Tenney in Green v. Hamilton Internatl Corp, 437 FS 723 (S.D.N.Y. 1977). We have examined Broad v. Rockwell Internatl Corp., supra, with care and note that it was a merger case wherein in the merger agreement, the debenture holders still retained the right to convert into cash but were denied the right to convert into stock and it was held that they had no standing under Blue Chips. It was further held there was no evidence of scienter. It

was pointed out by the Fifth Circuit itself at page 437 that it had not been willing to extend the definition of purchaser or sale to the extent that the Second and Third Circuits had. See also *Penn Central Securities*, 494 F 2d 528 (3d cir 1974); *Vine v. Beneficial Finance Co.*, 374 F 2d 627 (2d cir); cert den 389 US 970 (1967); *Drachman v. Harvey*, 453 F 2d 773 (2d cir 1972).

In the light of the foregoing we will deny the motion for summary judgment based upon these grounds.

Defendants also claim that the action is barred by the Pennsylvania Statute of Limitations, 70 Purdon's PS 1-504(a) which reads as follows:

"No action shall be maintained to enforce any liability created under section 501 (or section 503 in so far as it relates to that section) unless brought before the expiration of three years after the act or transaction constituting the violation *or the expiration of one year after the plaintiff receives actual notice or upon the exercise of reasonable diligence should have known the facts constituting the violation, whichever shall first expire.*"

The fact that Mr. Ezra Lowry may have testified in a certain way at depositions is not necessarily conclusive on this question of actual notice or knowledge or when he or his wife knew enough of the alleged violations to act. We will therefore wait until there has been a trial on the merits with respect to this matter.

In light of the foregoing, defendant's motion for summary judgment will be denied.

See also *Zeffiro v. First Pennsylvania Banking and Trust Co.* (3d cir No. 79-2259, May 29, 1980) holding that debenture holders do have a right to sue under the trust indenture act applying the tests in *Cort v. Ash*, 422 US 66 (1975).

s/ William W. Knox

U.S. District Judge

CC: Counsel of record.

**United States Court of Appeals
For The Third Circuit**

No. 81-1976

LUCILE LOWRY and LOWRY-ZWEIG CORP.,

Appellants

vs.

THE BALTIMORE AND OHIO RAILROAD COMPANY,
THE CHESAPEAKE & OHIO RAILROAD COMPANY AND
CHESSIE SYSTEM INC.

(D.C. Civil No. 79-1504)

**ON APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE WESTERN DISTRICT OF
PENNSYLVANIA**

Present: SEITZ, *Chief Judge*; ALDISERT, ADAMS, GIBBONS, HUNTER, GARTH, SLOVITER and BECKER, *Circuit Judges*.

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the Western District of Pennsylvania and was argued by counsel on December 16, 1981, and reargued before the Court in banc on November 8, 1982.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court, entered May 18, 1981, be, and the same is hereby affirmed insofar as it dismissed the federal claims of the appellants and vacated insofar as it dismissed the state law claims, and the cause remanded for proceedings consistent with the opinion of this Court. Each side to pay its own costs.

ATTEST:
s/ Sally Mrvos
Clerk

May 10, 1983

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 81-1976

LUCILE LOWRY and LOWRY-ZWEIG CORP.,
Appellants

v.

THE BALTIMORE AND OHIO RAILROAD
COMPANY,
THE CHESAPEAKE & OHIO RAILROAD COMPANY
and CHESSIE SYSTEM INC.

Present: SEITZ, *Chief Judge*;
ALDISERT, ADAMS, GIBBONS, HUNTER, GARTH,
SLOVITER and BECKER, *Circuit Judges*

The petition by appellants for Modification of the "Opinion of the Court — Per Curiam" and Judgment, by reinstating the federal claims of plaintiffs-appellants is denied.

Chief Judge Seitz, Judge Gibbons, Judge Becker would grant the petition.

By the Court,

JAMES HUNTER, III

Judge

Dated: July 5, 1983

STATEMENT RE DENIAL OF PETITION FOR MODIFICATION OF JUDGMENT

GIBBONS, *Circuit Judge*.

Lucille Lowry and Lowry-Zweig Corp. have petitioned for modification of the judgment entered by this court in the above entitled matter insofar as the judgment purported to affirm the dismissal of their federal law claims. They point out, and it is undisputed, that the sole basis for the district court's dismissal of those claims was rejected by a majority of this court in banc. They point out, further, and it is undisputed, that in an earlier pretrial ruling the district court held that federal law causes of action attaching to securities were automatically assigned on transfer of those securities and thus belonged to the plaintiffs. Finally they point out, and it is undisputed, that there is no majority in the court in banc for a reversal of the district court's ruling on automatic assignability of federal law claims. Under those circumstances, they urge, the only proper judgment is a reversal of the dismissal of the federal law claims.

In *United States v. Bazzano*, No. 81-1836, a case argued before the court in banc on the same day that this case was argued, no majority of the court could agree upon a reason for reversing either of the rulings of the district court upon which the judgment appealed from rested. The consequence, properly so, was an affirmance of that judgment. No explanation has been proffered by this court for the inconsistent treatment of the litigants with respect to an identical issue of appellate procedure arising in two cases argued on the same day. No explanation that could stand public scrutiny can be given.

The petition to modify the judgment should be granted. It has not been. But if the Supreme Court is concerned about public perceptions as to the integrity of

the federal appellate process, it should grant certiorari in this case and formally vacate the unsupportable judgment of this court.

A True Copy:

Teste:

*Clerk of the United States Court of Appeals
for the Third Circuit*

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF PENNSYLVANIA
LUCILE LOWRY and LOWRY-ZWEIG CORP.,

Plaintiffs,

-against-

THE BALTIMORE AND OHIO RAILROAD COMPANY,
THE CHESAPEAKE & OHIO RAILROAD COMPANY and
CHESSIE SYSTEM, INC.,

Defendants.

No. 79-1504-B

**PLAINTIFFS' MEMORANDUM IN SUPPORT OF
MOTION FOR CLASS ACTION DETERMINATION
INTRODUCTORY**

This memorandum, in behalf of the *Lowry* plaintiffs, responds to defendants' Brief in Opposition to Class Action Determination. We will also comment on an unsigned two-page "File" memorandum dated December 17, 1979, submitted at the hearing that day by Mr. Malakoff in behalf of the *Guttman* plaintiffs.

According to the defendants:

1. The *Lowry* plaintiffs lack standing to sue under Rule 10b-5 because neither is a defrauded purchaser or seller.

* * *

POINT II

**BY OPERATION OF LAW THE DAMAGE CLAIMS
ARISING FROM THE DECEMBER 13, 1977 DIVIDEND
DECLARATION PASSED TO THE PRESENT HOLDERS
OR, IN THE CASE OF CONVERSIONS, TO THE LAST
HOLDERS**

Concededly federal law should first be looked at to determine plaintiffs' standing to assert a federal cause of action. *In re Pittsburgh & L.E.R. Co.*, 543 F. 2d 1058, 1066-7 (3rd Cir.

1976). In applying "federal law" for this purpose, however, the court may find it appropriate to borrow from state law. *Id.* In that case the Third Circuit noted that in *Bangor Punta Operations, Inc. v. Bangor & Aroostook R.R. Co.*, 417 U.S. 703, 710-13 (1974), involving a claim founded on the Clayton Act, the Supreme Court invoked a state law doctrine stemming from *Home Fire Insurance Co. v. Barber*, 67 Neb. 644, 43 N.W. 1024 (1903), to dismiss the claim for want of the plaintiff's standing to sue.

Ours, too, is an appropriate case for borrowing from state law because of the meagerness of federal law on this vital subject. Neither defendants nor the *Guttman* plaintiffs[*] have so far cited a single federal case on the subject of whether bondholders' claims run with the security.

The only federal appellate case that we have found on the point explicitly holds that, as a matter of federal law, such claims run with the security. *Phelan v. Middle States Oil Corp.*, 154 F. 2d 978 (2d Cir. 1946). Involved there were the accounts of a federal court receiver for a number of corporations. A bondholder in one of the corporations had sought to surcharge the receiver for malfeasance detrimental to the bondholders. In reversing an order settling the accounts, the court, by Judge Jerome N. Frank, rejected the contention that the bondholder was without standing because his bonds had been purchased after commission of the alleged wrongs. Decision was placed on the ground that federal law, contrary to New York Law at the time, governed (pp. 1001-2):

What, then, is the "federal law" applicable here? In answering that question, we observed that the New York doctrine has this undesirable practical result: The seller of such bonds - ex hypothesi unaware, at the time of the sale, of the wrong done by the trustee

* The "*Guttman* plaintiffs" were consolidated in the District Court with the *Pittsburgh Terminal* action. Reference to "*Pittsburgh Terminal*" in the Petition for Certiorari includes the *Guttman* plaintiffs; reference to the *Guttman* plaintiffs in this class certification brief includes *Pittsburgh Terminal*.

- in actual fact can have no notion of retaining any cause of action against the trustee; and the seller of a bearer bond is exceedingly hard to trace. The practical consequence of the New York rule therefore is that most of the claims against a trustee for wrong done, especially to holders of bearer bonds, will never be prosecuted unless the trustee has surrendered trust assets. That rule thus often serves, pragmatically, as a convenient means of trustee exculpation.

* * * * *

It is suggested that a purchaser (such as Cohen) should have no right against a receiver because otherwise the purchaser will acquire a windfall, since he, like the seller, knew nothing of that right when he purchased. But in a great variety of instances, purchasers are permitted to acquire windfalls, e.g., a buyer of land on which oil is discovered after the sale. The Restatement of Contracts, § 171(2) reads: "Unless otherwise provided in the assignment or by agreement of the assignee with the assignor or with the obligor, an assignee under an effective assignment for value has the same right to any securities for the assigned right that were available to the assignor, though he has not bargained for them, as if the assignor has agreed to transfer them." If Glass was guilty of wrongdoing, that Cohen's estate will unexpectedly benefit can work no harm to Glass. We therefore reject the New York rule and apply the rule adopted elsewhere.

Accordingly, we hold that appellants have the right, for their own benefit and that of other holders of non-deposited bonds to have Glass surcharged on account of his wrongdoing, if any. [Footnotes omitted.]

In an earlier passage, at page 1000, Judge Frank wrote that New York stood alone with its doctrine that a sale of negotiable instruments does not carry with it claims for related wrongdoing

preceding the sale.* Apparently in response to that observation and Judge Frank's criticism of its decisional law, New York in 1950** enacted what has now become General Obligations Law, 23A McKinney's Consol. L., § 13-107:

Unless expressly reserved in writing, a transfer of any bond shall vest in the transferee all claims or demands of the transferrer, whether or not such claims or demands are known to exist, (a) for damages or rescission against the obligor on such bond,

Article 8 of the Uniform Commercial Code contains provisions to similar effect, adopted by all the states and the Virgin Island.*** Thus, by way of example, 12A P.S. § 8-301:

Upon delivery of a security the purchaser acquires the rights in the security which his transferor had or had actual authority to convey

" 'Rights' include remedies." § 1-201(36). " 'Remedy' means any remedial right to which an aggrieved party is entitled with or without resort to a tribunal." § 1-201(34). [Debentures are governed by Article 8 dealing with investment securities rather than Article 3 pertaining to negotiable instruments; § 8-102 (1) (b)]

Independent Investor Protective League v. Saunders, 64 F.R.D. 564 (E.D. Pa. 1974), is the only other "federal law" case which we have found on the question whether bondholders' claims run with the security. Contrary to the position of the *Lowry* plaintiffs, Judge Lord held, at page 572, that bondholders' claims under the Exchange Act and other federal securities laws do not run with the securities. He called the plaintiffs' theory that such claims run with the bonds "novel", "extraordi-

* For a review and sharp critique of the controlling New York decisions in the era of the *Phelan* case, see S.N. Corbin, *The Subsequent Bondholder and the Delinquent Trustee*, 51 Colum. L.R. 813 (1951).

** Not in 1963 as erroneously stated at p. 3 fn. of Mr. Block's affidavit in support of the *Lowry* plaintiffs' motion for class action determination.

*** See *Uniform Laws Annotated, Master Edition 1979, Directory of Acts, etc.* (pamphlet).

nary" and "entirely without any support in precedent" as well as "totally without merit." Judge Lord obviously overlooked Judge Frank's observations and ruling in *Phelan v. Middle States Oil Corp.*, 154 F. 2d 978 (2d Cir. 1946), *supra*, and the state statutes just noted. Plainly the issue was inadequately presented to Judge Lord; he has yet to be cited on the point in any decision which we have been able to find.

In similar vein, Mr. Malakoff concluded his "File" memorandum of December 17, 1979 with the suggestion that the doctrine espoused by the *Lowry* plaintiffs smacks of champerty, citing *Kenrich Corp. v. Miller*, 377 F. 2d 312, 314 (3rd Cir. 1967). Of course the law has long since outgrown condemnation of the assignment or transfer of choses in action, except where the transfer is in consideration of a share of the proceeds. 14 S. Williston, *Contracts*, § 1715 (3rd Ed. 1972); 4 A. L. Corbin, *Contracts*, § 886 (1951); 14 C.J.S., *Champerty and Maintenance*, § 5; 6A C.J.S., *Assignments* §§ 35-40. And in *Kenrich* it was not the transferee of a security, but the transferor, who was held to lack standing to sue derivatively in behalf of the corporation after selling his stock.

Defendants, br. pp. 3-4, argue, in effect, that the *Lowry* plaintiffs fail to fulfill Rule 10b-5's requirement that a plaintiff be a purchaser or a seller. As observed by A.S. Jacobs, 5 *The Impact of Rule 10b-5*, p. 2-40 (1979), the Birnbaum/Blue Chip* doctrine is not dictated by the language of either § 10(b) or the Rule. If it were, as Mr. Jacobs goes on to point out, judicially created exceptions to the doctrine could not exist.

One long recognized exception is an assignee or other transferee of a 10b-5 claim. *Mills v. Sarjem Corp.*, 133 F. Supp. 753, 761-2 (D. N.J. 1955); *International Ladies' Garment Workers' Union v. Shields & Co.*, 209 F. Supp. 145, 149-50 (S.D.N.Y. 1962); III L. Loss, *Securities Regulation*, pp. 1817-19 (2d Ed. 1961 and 1969 Suppl.). Both cited cases sustained the transferees' standing to sue while explicitly noting that § 25(a) of the Exchange Act, 15 U.S.C. § 78bb, limits recovery to the actual

* *Birnbaum v. Newport Steel Corp.*, 193 F. 2d 461 (2d Cir.), *cert. den.* 343 U.S. 956 (1952); *Blue Chip v. Manor Drug Stores*, 421 U.S. 723 (1975).

damages sustained by a plaintiff. See also *Western Auto Supply Co. v. Gamble-Skogmo, Inc.*, 348 F. 2d 736 (8th Cir. 1965), *cert. den.* 382 U.S. 987 (1966), holding assignable to claim under § 16(b) of the Exchange Act, 15 U.S.C. § 78p(b), for the recovery of short swing profits.

Defendants' citation, *br. p. 4*, of *deHass v. Empire Petroleum Co.*, 286 F. Supp. 809 (D. Col. 1968), on plaintiffs' supposed lack of standing, is completely off target. *deHass* was a derivative suit governed by Rule 23.1 which in terms requires plaintiff to have been a shareholder at the time of the transaction of which he complains. The Rules of Civil Procedure have no such requirement with regard to damage claims of holders of debt securities, nor has any such requirement been imposed by decisional law except for the previously discussed New York cases antedating that state's enactment of General Obligations Law § 13-107 and except for Judge Lord's ruling in *Independent Investor Protective League v. Saunders*, 64 F.R.D. 564 (E.D. Pa. 1974), *supra*.

The case at bar, we submit, strikingly indicates the soundness of the doctrine urged by the *Lowry* plaintiffs. The Debentures trade in bearer form.* Bearer bonds, of course, pass by delivery; and even holders rarely maintain a record showing ownership of particular bonds as of a particular date. As noted by Judge Frank in *Phelan v. Middle States Oil Corp.*, 154 F. 2d 978, 1001 (2d Cir. 1946), *supra*, "the seller of a bearer bond is exceedingly hard to trace."**

The *Guttmann* plaintiffs, and seemingly defendants as well, would have it that only current holders of debentures who were

* See affidavit submitted herewith of Stephen L. Joseph.

** Elaborating on the same theme, Judge Frank wrote in *Brooklyn Trust Co. v. Kelby*, 134 F. 2d 105, 110 n.7a (2d Cir.), *cert. den.* 319 U.S. 767 (1943):

As most of the bonds were bearer bonds this meant that any substantial recoveries would be highly unlikely, for it would be practically impossible, in most cases, to discover who owned bonds when any particular violation of the trust agreement occurred.

such on December 13, 1977 have standing to sue.* How many such holders, of what quantities of Debentures, exist at this time is anyone's guess. Whatever the count may be now, it is sure to be substantially reduced if and when plaintiff's recover a final judgment in their favor. The position of defendants and the *Guttman* plaintiffs on standing to sue is calculated radically to reduce defendants' exposure and, by the same token, to limit recovery to relatively few holders like the *Guttman* group with both the prescience and the resources for retaining the Debentures continuously from December 13, 1977 until the rendition of final judgment.

* * *

CONCLUSION

The Court should determine that the *Lowry* action is to be maintained as a class action and enter its order accordingly.
DATED: January 18, 1980.

* Mr. Wentley, in his oral argument, claimed that Debenture holders lack standing to sue because the Indenture vests all rights of action exclusively in the Trustee - which thus far has been inert and is not required to act unless requested by the holders of not less than 25% of the principal amount of Debentures together "with offer of indemnity satisfactory to the Trustee" (Indenture Article Seven, § 6, set out in the Appendix hereto). [The Debentures, because issued by a regulated common carrier, are exempted from the provisions of the Trust Indenture Act of 1933, under § 6(c) (a) thereof, 15 U.S.C. § 77ddd (a) (4).]

Mr. Wentley's point, we submit, was ill-founded because sub-¶ (b) of § 6 excepts from its direct suit restriction an action by a Debenture holder "to enforce . . . his right . . . to convert his Debentures, in the manner provided therein or in this Indenture." Arguably the privilege of direct suit, so reserved to protect Debenture holders' rights of conversion, is exercisable only by Debenture holders who are such at the time of suit.

If this be so and the subject claims do not run with the Debentures, the putative *Guttman* class encompasses the only Debenture holders having a present right of action. On these two hypotheses, even those holders will lose their standing to continue suit should they part with their Debentures before final judgment.

Respectively submitted,
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**IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA**

LUCILE LOWRY and LOWRY-ZWEIG CORP.,
Plaintiffs,

v.

**THE BALTIMORE AND OHIO RAILROAD COMPANY,
THE CHESAPEAKE & OHIO RAILROAD COMPANY and
CHESSIE SYSTEM, INC.,**

Defendants.
No. 79-1504-B

**DEFENDANTS' REPLY TO PLAINTIFFS'
MEMORANDUM IN SUPPORT OF MOTION FOR CLASS
ACTION DETERMINATION**

Defendants have previously addressed most of the arguments advanced by plaintiffs and, therefore, will not attempt a seriatim refutation of plaintiffs' arguments. One important point needs to be reiterated, however:

**PLAINTIFFS HAVE NO STANDING TO PROSECUTE
THIS ACTION**

As plaintiffs correctly point out to the Court, p. 8, Plaintiffs' Memorandum, in the most recent case to decide the issue, Chief Judge Lord held that "plaintiff's theory [that] the simple act of buying a bond, without more, also purchases all rights of action that any prior holder might have had * * * is entirely without any support in precedent and, we think, totally without merit." *Independent Investors Protection League v. Saunders*, 64 F.R.D. 564, 572 (E.D.Pa. 1974). There, thus, can be no question, under the controlling law, that plaintiffs lack standing to maintain any action for themselves and also as class represen-

tatives since they seek to assert their rights solely as transferees. Furthermore, it is clear under *Saunders, supra*, that many of the putative plaintiffs they seek to represent (i.e., those who, like the present plaintiffs, purchased their Debentures *after* the December 13, 1977 dividend declaration) are also barred from maintaining this action.

Defendants respectfully request that this Honorable Court deny Plaintiff's Motion for Class Action Determination.

Respectfully submitted,

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Anthony J. Basinski

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Counsel for Defendants,

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Chessie System, Inc.

**IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA**

LUCILE LOWRY and LOWRY-ZWEIG CORP.,

Plaintiffs,

v.

**THE BALTIMORE AND OHIO RAILROAD COMPANY,
THE CHESAPEAKE & OHIO RAILROAD COMPANY and
CHESSIE SYSTEM, INC.,**

Defendants.

Civil Action No. 79-1504-B

**SUPPLEMENTAL BRIEF IN OPPOSITION TO CLASS
ACTION DETERMINATION**

On December 17, 1979 this Court heard oral argument on the plaintiffs' Motion for Class Action Determination. Prior to argument, defendants had filed a Brief in Opposition to that Motion. At argument, the Court requested the submission of additional briefs on the issues raised by the motion and Defendants' Response.

* * *

**II. PLAINTIFFS HAVE NO STANDING TO PURSUE
THIS ACTION**

Defendants contend that plaintiffs lack standing to maintain this action under Rule 10b-5 because their purchases of the B&O Debentures, which are the subject matter of the suit, were not "in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5 (1977). Plaintiffs have countered that they may maintain the action as transferees under some obscure New York statute. There is, however, a strong interest in preventing parties from speculating on a lawsuit. Plaintiffs

purchased the B&O Debentures with just such an idea in mind. (Deposition of Ezra J. Lowry at p. 21).

In the case of *Bangor Punta Operations, Inc. v. Bangor & Aroostock Railroad Co.*, 417 U.S. 703 (1974), the Supreme Court of the United States expressed its disapproval of such speculations. There, the Court followed the principles first laid down by Dean Roscoe Pound in *Home Fire Insurance Co. v. Barber*, 67 Neb. 644, 93 N.W. 1024 (1903):

"Dean Pound, writing for the Supreme Court of Nebraska, observed that the shareholders of the plaintiff corporation in that case had sustained no injury since they had acquired their shares from the alleged wrongdoers after the disputed transactions occurred and had received full value for their purchase price. Thus, any recovery on their part would constitute a windfall, for it would enable them to obtain funds to which they had no just title or claim. Moreover, it would in effect allow the shareholders to recoup a large part of the price they agreed to pay for their shares, notwithstanding the fact that they received all they had bargained for. Finally, it would permit the shareholders to reap a profit from wrongs done to others, thus encouraging further such speculation. Dean Pound stated that these consequences rendered any recovery highly inequitable and mandated dismissal of the suit." 417 U.S. at 711.

These same principles must apply herein.⁴ Plaintiffs bought all of their Debentures after the December 13, 1977 dividend declaration which forms the basis of their complaint (Complaint, ¶¶ 11, 12). Furthermore, most of those purchases were made after plaintiffs learned of the existence of the *Pittsburgh Terminal* action (Deposition of Ezra J. Lowry at pp. 24-28). These plaintiffs purchased their Debentures with full and complete knowledge of all of the relevant facts. To permit them to recover would indeed be an unwarranted windfall for them.

⁴ Of course, these considerations apply equally to plaintiffs' federal claims and their pendent state law claims as they depend upon the same set of facts.

Therefore, because the plaintiffs' claims are not "typical of the claims . . . of the class," F. R. Civ. P. 23(a)(3), they may not maintain this action as a class action.

CONCLUSION

For the reasons set forth in this Brief and their earlier Brief, Defendants respectfully request this Honorable Court to deny plaintiffs' Motion for Class Action Determination.

Respectfully submitted,

s/ Richard T. Wentley

Richard T. Wentley

s/ Anthony J. Basinski

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Railroad and Chessie System, Inc.

**IN THE UNITED STATES DISTRICT COURT FOR
THE WESTERN DISTRICT OF PENNSYLVANIA**

LUCILE LOWRY and LOWRY-ZWEIG CORPORATION,
Plaintiffs,

v.

THE BALTIMORE AND OHIO RAILROAD COMPANY, *et*
al.,

Defendants.

Civil Action No. 79-1504

**DEFENDANTS' MOTION FOR SUMMARY JUDGMENT
AND, ALTERNATIVELY, DEFENDANTS' MOTION TO
DISMISS**

AND NOW come defendants, The Baltimore and Ohio Railroad Company ("B & O"), The Chesapeake and Ohio Railway Company ("C & O") and Chessie System, Inc. ("Chessie"), by and through their counsel, Richard T. Wentley, Anthony J. Basinski and Reed Smith Shaw & McClay, and do hereby move for summary judgment in the above action pursuant to Rule 56 of the Federal Rules of Civil Procedure, or, alternatively, move for dismissal of the above action pursuant to Rule 12 of the Federal Rules of Civil Procedure, and in support thereof do aver as follows:

1. Plaintiffs have alleged that the dividend declared by the B & O on December 13, 1977 to its common stockholders payable in the stock of a wholly-owned subsidiary of the B & O, Mid-Allegheny Corporation ("MAC"), was in derogation of their rights as holders of certain convertible Debentures ("Debentures") of the B & O and in violation of §10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder.

2. Neither of the named plaintiffs was a holder of the Debentures on December 13, 1977, the date of the dividend declaration (Complaint, ¶¶ 11, 12).

3. Because they were not Debentureholders on that date, any alleged fraud was not "in connection with" the purchase or sale of their securities as required by Rule 10B-5. Accordingly, the representative plaintiffs, and those similarly situated, lack standing to maintain this action.

4. Plaintiffs were aware some time in December 1977 that the declaration and payment dates of the MAC dividend were the same (Deposition of Ezra J. Lowry at 21).

5. Under the applicable Pennsylvania Blue Sky Law, 70 P.S. §1-504(a), plaintiffs' cause of action was barred one year after plaintiffs knew or should have known of "the facts constituting the violation."

6. Plaintiffs did not commence their action until October 22, 1979, nearly two years after the action complained of.

7. The representative plaintiffs, and those similarly situated, are barred from maintaining this action by the applicable statute of limitations.

8. The plaintiffs and defendants are in agreement that this Court may decide the within motion on the basis of the briefs and other papers filed by the parties in support of and in opposition to plaintiffs' motion for class action determination.

WHEREFORE, defendants move this Honorable Court for an order granting summary judgment in their favor for the reason that there is no genuine issue as to any material fact and that they are entitled to such judgment as a matter of law, or alternatively, dismissing the within action.

s/ Anthony J. Basinski

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April 28, 1980

Honorable William W. Knox
 United States District Court
 Western District of Pennsylvania
 U.S. Post Office and Courthouse
 Pittsburgh, PA 15219

Re: *Lowry v. B&O (Civ. 79-1504-B)*

Dear Judge Knox:

With reference to defendants' motion for summary judgment, etc. accompanied by certificate of service dated April 24, 1980:

The motion, ¶ 8, correctly states that the parties are in agreement that the Court may decide the motion on papers filed in support of and in opposition to plaintiffs' motion for class action determination. For the Court's convenience, plaintiffs' papers on that motion are listed below:

Notice of Motion dated October 22, 1979 and Supporting Affidavit sworn to October 12, 1979.

Plaintiffs' Memorandum in Support of Motion for Class Action Determination dated January 18, 1980.

Affidavit of Stephen L. Joseph sworn to January 16, 1980.

Plaintiffs' Reply Memorandum in Support of Motion for
Class Action Determination dated January 25, 1980.

Respectfully,

Robert B. Block

RBB:rrf

cc: Michael P. Malakoff, Esq.

Hon. Richard T. Wentley

T. Lawrence Palmer, Esq.

Section 10(b), Securities Exchange Act of 1934, 15 U.S.C.
§ 78j(b):

**REGULATION OF THE USE OF MANIPULATIVE AND
DECEPTIVE DEVICES**

Sec. 10. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5, 17 C.F.R. § 240.10b-5:

**Rule 10b-5. Employment of Manipulative and Deceptive
Devices.**

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Uniform Commercial Code, § 8-301:

§ 8-301. Rights Acquired by Purchaser; "Adverse Claim"; Title Acquired by Bona Fide Purchaser

(1) Upon delivery of a security the purchaser acquires the rights in the security which his transferor had or had actual authority to convey except that a purchaser who has himself been a party to any fraud or illegality affecting the security or who as a prior holder had notice of an adverse claim cannot improve his position by taking from a later bona fide purchaser. "Adverse claim" includes a claim that a transfer was or would be wrongful or that a particular adverse person is the owner of or has an interest in the security.

(2) A bona fide purchaser in addition to acquiring the rights of a purchaser also acquires the security free of any adverse claim.

(3) A purchaser of a limited interest acquires rights only to the extent of the interest purchased.

Uniform Commercial Code, § 8-301 (as revised 1977):

§ 8-301. Rights Acquired by Purchaser

(1) Upon transfer of a security to a purchaser (Section 8-313), the purchaser acquires the rights in the security which his transferor had or had actual authority to convey unless the purchaser's rights are limited by Section 8-302(4).

(2) A transferee of a limited interest acquires rights only to the extent of the interest transferred. The creation or release of a security interest in a security is the transfer of a limited interest in that security.

New York General Obligations Law § 13-107 (McKinneys 1978):

§ 13-107. Claims or demands transferred with bond unless reserved

1. Unless expressly reserved in writing, a transfer of any bond shall vest in the transferee all claims or demands of the transferer, whether or not such claims or demands are known to exist, (a) for damages or rescission against the obligor on such bond, (b) for damages against the trustee or depository under any indenture under which such bond was issued or outstanding, and (c) for damages against any guarantor of the obligation of such obligor, trustee or depository.

2. As used in this section, "bond" shall mean and include any and all shares and interests in an issue of bonds, notes, debentures or other evidences of indebtedness of individuals, partnerships, associations or corporations, whether or not secured.

3. As used in this section, "indenture" means any mortgage, deed of trust, trust or other indenture, or similar instrument or agreement (including any supplement or amendment to any of the foregoing), under which bonds as herein defined are issued or outstanding, whether or not any property, real or personal, is, or is to be, pledged, mortgaged, assigned, or conveyed thereunder.

No. 83-211

IN THE

Supreme Court of the United States

October Term, 1983

LUCILE LOWRY and LOWRY-ZWEIG CORP.,
Petitioners

v.

THE BALTIMORE and OHIO RAILROAD COMPANY,
THE CHESAPEAKE and OHIO RAILWAY
COMPANY and CHESSIE SYSTEM, INC.,
Respondents

RESPONSE TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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peake and Ohio Railway Com-
pany and Chessie System, Inc.

QUESTIONS PRESENTED

- I. Does the defendants' good faith reliance on the advice of counsel preclude a finding of the scienter necessary to establish a violation of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5?
 - II. Does SEC Rule 10b-17 contravene the decision of this Court in *Ernst & Ernst v. Hochfelder* requiring scienter as a necessary element of a Rule 10b-5 violation?
 - III. Where five members of the eight judge en banc Court of Appeals, employing two separate legal rationales, vote to affirm the judgment of the District Court, is not affirmance of that judgment proper?
 - IV. Are claims under section 10(b) automatically assigned to a subsequent purchaser of a security?
-

**LISTING UNDER
SUPREME COURT RULE 28.1**

The CSX Corporation owns 100% of The Chesapeake and Ohio Railway Company.

The Baltimore and Ohio Railroad Company has the following subsidiaries and affiliates which come within Rule 28.1:

- a. The Baltimore and Philadelphia Railroad Company;
- b. Cleveland Terminal & Valley Railroad Company;
- c. Dayton and Michigan Railroad Company;
- d. Dayton and Union Railroad Company.

The Chesapeake and Ohio Railway Company has the following subsidiaries and affiliates which come within Rule 28.1:

- a. Chicago South Shore & South Bend Railroad;
 - b. Richmond-Washington Company;
 - c. Richmond, Fredericksburg & Potomac Railroad Company; and
 - d. Richmond Land Company.
-

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STATEMENT OF THE CASE

A. Procedural History

This action arises out of a dividend which was declared by the Board of Directors of The Baltimore and Ohio Railroad Company ("B&O") on December 13, 1977 payable to shareholders of record of B&O Common Stock on that date. The dividend was in the stock of a wholly-owned subsidiary of the B&O, Mid-Allegheny Corp. ("MAC"). The petitioners are holders of B&O Convertible 4½% Debentures ("the Debentures")¹ which they purchased *after* December 13, 1977 and with full knowledge of all of the circumstances surrounding the declaration of the dividend.

On October 22, 1979, petitioners filed a class action suit in the United States District Court for the Western District of Pennsylvania against the B&O, The Chesapeake and Ohio Railway Company ("C&O") and Chessie System, Inc. ("Chessie") alleging that the manner of the declaration of the MAC dividend, *inter alia*, violated Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) and Rule 10b-5, 17 C.F.R. § 240.10b-5, because Debentureholders had not received advance notice of the declaration of the MAC dividend.

At the time petitioners brought suit, there were two related private suits pending in the Western District, *Pittsburgh Terminal Corp. v. The Baltimore & Ohio R.R. Co.* and *Monroe Guttman v. The Baltimore & Ohio R.R. Co.* (collectively referred to as the "*Pittsburgh Terminal*" case). Those actions were brought by Debentureholders who had owned their Debentures on December

1. Each of the Debentures has a face value of \$1,000 and is convertible into ten shares of B&O Common Stock at any time before maturity in the year 2010.

13, 1977, the date of the MAC dividend, and also alleged violations of Section 10(b) and Rule 10b-5. The *Pittsburgh Terminal* case went to trial on July 21-24, 1980 before the District Court sitting without a jury. The trial court on March 10, 1981 entered judgment in favor of all defendants and dismissed the complaints finding, *inter alia*, the plaintiffs had failed to prove that the defendants possessed the requisite scienter to establish a violation of Section 10(b) and Rule 10b-5.

Following the dismissal of the *Pittsburgh Terminal* action, the Defendants moved for summary judgment in the *Lowry* case solely on the basis of the District Court's decision in *Pittsburgh Terminal* (Supplemental Appendix 1b). Counsel for the *Lowry* plaintiffs submitted a letter to the Court (Supplemental Appendix 5b) in which he requested that this matter be decided, as stated by the District Court, "on the basis of the decision in the *Guttman* cases without receiving any further evidence considering all the papers in the cases as submitted for determining defendant's motion for summary judgment". (63a) The *Lowry* plaintiffs "asserted that by entering judgment now, this matter could be presented to the circuit at the same time as the other cases". (62a). The District Court stated that "[u]nder the circumstances, the court is willing to comply" (63a) and entered summary judgment in favor of the defendants (60a).

The plaintiffs in *Pittsburgh Terminal* and *Lowry* both filed appeals with the United States Court of Appeals for the Third Circuit ("Third Circuit") and the cases were consolidated for appeal purposes. Argument was heard before a panel of the Third Circuit on December 17, 1981 in *Pittsburgh Terminal* and *Lowry*. On June 3, 1982, without explanation, the Third Circuit issued its decision in the *Pittsburgh Terminal* case only, reversing

the District Court's decision and remanding for a determination of the appropriate relief. *Pittsburgh Terminal Corp. v. Baltimore & Ohio R.R. Co.*, 680 F.2d 933 (3d Cir.), *cert. denied*, 103 S.Ct. 476 (1982). The panel's decision (two judges concurring, one dissenting) rested solely on a finding that the defendants had failed to give ten days advance notice of the MAC dividend in accordance with SEC Rule 10b-17, 17 C.F.R. § 240.10b-17 (1981). Subsequently, on June 22, 1982, the Third Circuit *sua sponte ordered argument en banc* in *Lowry* only, again without explanation. Thus, these two cases, which had been joined together for appeal purposes and which were mutually dependent upon each other, became unconnected through no fault of the defendants.

Defendants petitioned this Court for a writ of certiorari in the *Pittsburgh Terminal* case on October 6, 1982. No. 82-622, October Term, 1982. Meanwhile, reargument *en banc* was held before the Third Circuit on November 8, 1982 in the *Lowry* case. On November 29, 1982, this Court denied certiorari in the *Pittsburgh Terminal* case. It was not until May 10, 1983, however, that the Third Circuit issued its decision in *Lowry*.

In its *per curiam* opinion and judgment, the *en banc* Third Circuit dismissed all of the *Lowry* plaintiffs' claims under the federal securities laws. (Supplemental Appendix 4b). The basis for the judgment was that three judges (Adams, Garth and Sloviter, C.J.J.) did not believe that causes of action under Rule 10b-5 are automatically assignable to subsequent purchasers (i.e., the *Lowrys*) of the Debentures; and that two of the judges, (Aldisert and Hunter, C.J.J.) did not believe that Rule 10b-5 was in any way violated. While dismissing the *Lowry* plaintiffs' federal claims by a vote of 5-3, the Third Circuit unanimously remanded the state claims (those under the In-

denture, New York Stock Exchange Rules and other common law claims for breach of fiduciary duty) to the District Court.

As noted above, the decision of the Third Circuit in *Pittsburgh Terminal* rests entirely upon a finding by the panel that the defendants had failed to comply with Rule 10b-17 (an issue raised for the first time on appeal by the SEC in its *amicus* brief in *Pittsburgh Terminal* and not raised at all in *Lowry*). It is the defendants' contention that this holding was erroneous and that the fact that the defendants did not violate Rule 10b-5 provides yet another ground for the affirmance of the *Lowry* judgment (as found by two judges of the *Lowry en banc* Court).²

B. Factual Background

The declaration of the dividend of MAC shares was an essential part of a corporate reorganization of Chessie that began in 1973. This reorganization was designed to segregate in a separate corporation the assets of the C&O, wholly-owned by Chessie, and its subsidiaries, in-

2. Petitioners suggest that collateral estoppel bars this contention because of the denial of certiorari by this Court in *Pittsburgh Terminal*. The law is well-settled, however, that the denial of certiorari does not constitute an adjudication on the merits, *Hughes Tool Co. v. TWA*, 409 U.S. 363, 365 n. 1 (1973), and that this Court may look back and correct any errors that may have occurred during any stage of the proceedings. *Mercer v. Theriot*, 377 U.S. 152 (1964). Furthermore, it would indeed be anomalous if the defendants were collaterally estopped in this case where, through no fault of their own, these related matters, once consolidated on appeal, were decided separately, contrary to the counsel of this Court. See *Reed v. Allen*, 286 U.S. 191, 198 (1932).

cluding the B&O, which were not essential for rail operations. In order to effectuate the transfer of the B&O non-rail assets, it was decided by a Corporate Restructuring Committee within Chessie that those assets should be transferred to MAC, a wholly-owned subsidiary of the B&O. The B&O, in turn, would declare a dividend-in-kind in the shares of MAC on its common stock.³ The C&O would then declare a dividend of the MAC shares it received to its sole shareholder, Chessie. Chessie would then contribute its MAC shares to a development company called Chessie Resources, Inc., where the nonrail properties could be developed free of restrictions imposed by the Interstate Commerce Commission on railroads. No challenge has ever been made to this manner of proceeding by any of the plaintiffs in these cases.

The only challenge, and the only basis for plaintiffs' claims under Rule 10b-5, has been to the decision of the B&O to make the declaration, record and payment dates of the MAC dividend the same. Recommendation for that course of action was made by counsel for the B&O, Robert F. Hochwarth ("Hochwarth") in order that the MAC dividend would be eligible for a "no action" letter from the SEC⁴. The B&O desired such a no action letter

3. In December, 1977, 99.63% of the common stock of the B&O was under the control of the C&O. The remaining shares were held by thirteen minority shareholders who would also receive the MAC dividend, thus retaining their proportionate interest in all of the properties of the B&O.

4. This procedure was found to be in accord with the law governing dividends by a Maryland corporation such as the B&O. Maryland Corporations and Associations, §2-511.

in order to avoid the necessity of filing a registration statement with the SEC.⁵

In connection with this recommendation, Hochwarth consulted with attorneys from an outside law firm, that had been retained because of its expertise in securities law. In November, 1977, prior to the MAC dividend, Hochwarth outlined to a senior partner at the law firm, the proposal to make the date of record, declaration and payment the same, and asked him to "[p]lease let me know if you see any problems with this procedure". No attorney at the firm ever raised any objection to that proposal. Furthermore, the firm prepared the request for a no action letter which was submitted to THE SEC.

Hochwarth and Roland Donnem ("Donnem"), Vice President, Law for the B&O, considered whether there was an obligation for the B&O to give ten (10) days advance notice of the MAC dividend to the New York Stock Exchange ("NYSE"). A requirement to give notice of certain dividends was contained in the listing agreement for the B&O common stock, which was incorporated by reference in the listing agreement for the Debentures. Hochwarth and Donnem, however, concluded that the ten day advance notice requirement did not apply to the MAC dividend because it was applicable only to dividends declared on stocks listed on the NYSE and the B&O common stock had neither been listed nor traded for at least two years prior to the declaration of the MAC dividend.

5. On September 7, 1979, after it had long been aware of the *Pittsburgh Terminal* lawsuit, the SEC issued the requested no action letter.

While neither Hochwarth nor Donnem specifically considered whether notice had to be given pursuant to Rule 10b-17, the Third Circuit's predicate for liability in the *Pittsburgh Terminal* case, the notice required by that Rule is met if "[g]iven in accordance with procedures of the national securities exchange or exchanges upon which a security of such issues is registered . . . which contain requirements substantially comparable to those set forth in paragraph (b)(1) of this section". § 240.10b-17(b)(2).

ARGUMENT

I. Defendants Are Not Liable Under Rule 10b-5

A. DEFENDANTS GOOD FAITH RELIANCE ON THE
ADVICE OF COUNSEL PRECLUDES A FINDING OF
SCIENTER

Petitioners in their Petition for Certiorari do not directly address the question of defendants' liability under Rule 10b-5. Defendants believe, however, that the fact that the defendants did not violate the securities' laws provides yet another ground for the affirmance of the Third Circuit's decision. Since all of the judges on the *en banc* court discussed the issue, defendants believe that it forms a proper ground for review in this Court. Because defendants believe that the panel's holding in *Pittsburgh Terminal* was wrongly decided, it is hoped that this Court will grant review of this matter to affirm that there has been no violation of the securities laws by the defendants.⁶

The finding of the Third Circuit in *Pittsburgh Terminal* is that "[a] violation of Section 10(b) does not require a specific intention to break the law. It requires only knowing or intentional actions which, objectively examined amount to a violation". 680 F.2d at 942. This holding has been roundly criticized. Francis M. Wheat, former commissioner of the SEC and distinguished securities lawyer, has stated that the Third Circuit in *Pittsburgh Terminal* announced "a standard for 'scienter' which takes the guts out of the *Hochfelder* doctrine". Speech of Francis M. Wheat to Regional Se-

6. On the other hand, for the reasons stated *infra*, defendants will demonstrate that the issues advanced by petitioners do not merit this Court's review.

curities and Exchange Commission Seminar, Los Angeles, Calif. (October, 1982).

On the other hand, the SEC has interpreted the Third Circuit's holding as a weakening of the scienter standard because under the Third Circuit's decision scienter may be found in spite of the good faith reliance on the advice of counsel. Remarks of Jacob Stillman, Associate General Counsel, Securities and Exchange Commission, SEC Speaks (March 5, 1983). It thus appears that the argument which the SEC lost in *Ernst & Ernst v Hochfelder*, 425 U.S. 185, 198 (1976) has been won in *Pittsburgh Terminal* and perpetuated in *Lowry* unless this Court should act to reaffirm its guiding principles regarding scienter and liability under Rule 10b-5.

Since the Court denied certiorari in *Pittsburgh Terminal*, this Court decided the case of *Dirks v. Securities and Exchange Commission*, 51 U.S.L.W. 5123 (June 28, 1983) in which this Court affirmed many of those same principles abandoned by the Third Circuit in *Pittsburgh Terminal*. In ascertaining whether the defendant in that case was an "insider" subject to the restrictions on insider trading under Rule 10b-5, the Court reemphasized that "[n]ot 'all breaches of fiduciary duty in connection with a securities transaction', however, come within the ambit of Rule 10b-5. *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 472 (1977). There must also be 'manipulation or deception'. *Id.* at 473" 51 U.S.L.W. at 5125.

Furthermore, the Court went on to specifically discuss the type of scienter necessary to meet that requirement of "manipulation or deception":

"*Scienter*—'a mental state embracing intent to deceive; manipulate or defraud', *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976)—is an independent element of a Rule 10b-5 violation. See Aaron

v. SEC, 446 U.S. 680, 695 (1980). Contrary to the dissent's suggestion, see *post*, at p. 7, n.10, motivation is not irrelevant to the issue of *scienter*. It is not enough that an insider's conduct results in harm to investors; rather a violation may be found only where there is 'intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities'".

51 U.S.L.W. at 5127 n.23.

Although as noted, the dissenting justices in *Dirks* questioned whether motive was relevant to the requirement of *scienter*, those justices also acknowledged that the "scienter requirement functions in part to protect good faith errors". 51 U.S.L.W. at 5131 n.12.

In the present case, even assuming the applicability of Rule 10b-17 to the MAC dividend⁷, the undisputed facts are that the lawyers for the B&O specifically considered whether notice had to be given to the Debentureholders under the NYSE listing agreement, the functional equivalent of Rule 10b-17. See pp. 6-7, *supra*. They concluded that such notice did not have to be given. As Commissioner Bevis Longstreth of the Securities Ex-

7. Judge Adams, dissenting from the panel's holding in *Pittsburgh Terminal* made a strong argument that the panel's holding misreads Rule 10b-17 in that it was not designed to provide any substantive rights to investors, only protect those which they already had. 680 F.2d at 953. Since the Debentureholders had no right to advance notice under the Indenture under which the Debentures were issued, Rule 10b-17 cannot supply such a requirement. 680 F.2d at 954. Cf. *Broad v. Rockwell International Corp.*, 642 F.2d 929 (5th Cir.) (en banc), cert. denied, — U.S. —, 70 L.Ed2d 380 (1981).

change Commission has said in discussing the facts of this case: "If counsel is wrong as to the duty, an action based upon the contract will lie, regardless of counsel's advice and the defendant's good faith reliance on it. But to charge scienter under these circumstances, thereby affording a basis for an action under 10b-5, seems misplaced." Longstreth, *Reliance on Advice of Counsel as a Defense to Securities Law Violations*, 37 Bus. Law, 1185, 1196 (1982).

Commenting on Commissioner Longstreth's speech and the facts of this case, the leading commentators on the advice of counsel defense have also stated that "if legal advice concerning the duty to provide notice was an important element in the defendants' decision not to give notice, the fact that they knew what they were doing and knew the consequences of their actions does not amount to scienter because, based on that advice, they neither intended to, nor did they, act with deception". Hawes & Sherrard, "Speech May Suggest 'Advice of Counsel' Evolution", *Legal Times*, March 1, 1982, at 11, Col. 1.

The decision of the Third Circuit in *Pittsburgh Terminal* represents a step backward in the recognition that good faith reliance on the advice of counsel can negate the element of scienter. Cf. *Shidler v. All American Life and Financial Corp.*, [1982 Transfer Binder], CCH Fed. Sec. Law ¶ 98, 875 (Sept. 30, 1982); §1703(e), ALI, Federal Securities Code, (Proposed Official Draft, 1978). This Court now has the opportunity in the *Lowry* case to once again reaffirm the principles followed so recently in the *Dirks* case and banish the aberration of *Pittsburgh Terminal*.

**B. RULE 10B-17 CONTRAVENES THE HOCHFELDER
REQUIREMENT OF SCIENTER**

Rule 10b-17 provides in relevant part:

"It shall constitute a 'manipulative or deceptive device or contrivance' as used in section 10(b) of the Act . . . to fail to give notice in accordance with paragraph (b) of this section of the following actions . . ."

Thus, by its terms, the failure to give the required notice constitutes a violation of Section 10(b) without regard to whether scienter is present. Rule 10b-17 was adopted by the SEC in 1971, some five years before this Court's decision in *Ernst & Ernst v. Hochfelder, supra*, in which this Court held that scienter was a necessary element for a violation of Rule 10b-5. Up to the time of the Third Circuit's decision in *Pittsburgh Terminal*, there had been no case directly applying Rule 10b-17 to find a defendant liable under Section 10(b). Because Rule 10b-17 does not require scienter, it is respectfully submitted that the Rule is in direct contravention of this Court's holding in *Hochfelder*.

II. The Third Circuit Was Not Equally Divided; A Majority Was in Favor of Affirmance of the Judgment of the District Court Dismissing Plaintiff's Federal Claims

The Petitioners have contended that the Third Circuit erroneously affirmed the Judgment of the District Court dismissing the plaintiffs' claims under the securities laws. The basis for their contention is that the Third Circuit was equally divided on the issue of whether the plaintiffs as purchasers of Debentures after the date of the MAC dividend had received an automatic assignment

of the causes of action of their predecessors in interest under Rule 10b-5 and Section 10(b). While there were three judges on each side of this issue, there were in fact five judges in favor of the affirmance of the judgment of the District Court dismissing plaintiffs' claims under the securities laws and only three judges in favor of reversing that decision. Petitioners' argument is novel and without precedent in jurisprudence anywhere.

The first sentence of the *per curiam* opinion of the Court states that plaintiffs "appeal from a summary judgment dismissing their class action complaint". (2a). As stated by Judge Gibbons, that motion "was granted for the same reasons relied upon by the Trial Court in dismissing the *Pittsburgh Terminal* complaint". (35a). That is to say, the District Court dismissed the *Lowry* complaint at the request of the plaintiffs "on the basis of the decision in the *Guttman* cases without receiving any further evidence" that there had not been any violation of Rule 10b-5. (62a-63a). The dismissal of the plaintiffs' complaint by the District Court did not rest upon any determination whether the plaintiffs as subsequent Debentureholders had standing. Again, as noted by Judge Gibbons, "those issues [related to standing] are entirely apart from the grounds upon which summary judgment was entered". (36a). Yet it is from that judgment that the plaintiffs appealed.⁸

It is a fundamental rule of law that:

"[A]ppeals have to be taken from final judgments, not from judicial rationales. And court

8. Plaintiffs also appealed from two orders defining the class they could represent. (Supplemental Appendix 7b). Those orders are not the subject of any current controversy.

judgments may of course be supported by any sound judicial argumentation—or by none at all if they are correct legally. Judges have at least the solace of knowing that only judicial deeds—not judicial words—may constitute legal error.

Cook v. Hirschberg, 258 F.2d 56, 57 (2d Cir. 1958). Indeed, it is axiomatic that appellate courts “review judgments, not arguments”. *U.S. v. Shirey*, 359 U.S. 255, 261 n. 5 (1959). Frankfurter, J.)

Likewise, it is fundamental that “[w]here the decision below is correct it must be affirmed by the appellate court though the lower tribunal gave a wrong reason for its action”. *J. E. Riley Investment Co. v. Commissioner*, 311 U.S. 55, 59 (1940).

In the present case, two of the judges agreed with the District Court’s rationale in dismissing plaintiffs’ complaint: there was no violation of Rule 10b-5. Three judges applied a different rationale: plaintiffs had no standing as subsequent debentureholders who did not receive an express assignment of their predecessors’ causes of action. All told, however, five judges agreed with the judgment of the District Court and affirmed that judgment, albeit for two separate reasons. (see 21a, 26a).

Petitioners would have the Court believe, however, that because the Third Circuit was equally divided on the issue of automatic assignment, they should have prevailed. This ignores logic, common sense and the facts.

Petitioners contend that in reality before the Third Circuit they were seeking an affirmance of an alleged ruling of the District Court on the assignment question. This question was supposedly decided by the District Court in denying defendants’ first motion for summary judgment (66a). In the first instance, of course, that or-

der was not even before the Court of Appeals since no party appealed that order. Secondly, as noted by Judge Seitz in discussing the District Court's order, "in rejecting appellees' standing argument, the District Court did not determine whether the Lowrys, and other class members who had purchased after December 13, 1977, [Lowrys] had been assigned the 10(b) claims of their sellers, nor whether they could assert those claims as assignees". (52a). The sole basis for the District Court's decision, as can be seen by even the most cursory review of its decision, is that this Court's decision in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975) provided standing to Debentureholders without the need for a separate purchase or sale.⁹ Thus, it is clear that there was nothing for the Third Circuit to affirm on the assignment issue.

Furthermore, the cases of this Court have made it clear that "[i]n cases of appeal or writ of error in this court, the appellant or plaintiff in error is always the moving party. It is affirmative action which he asks. The question presented is, shall the judgment or decree be reversed? If the judges are divided, the reversal cannot be had, for no order can be made. The judgment of the court below, therefore, stands in full force". *Durant v. Essex Co.*, 7 Wall. 107, 112 (1869). Similarly, more recently in *Neil v. Biggers*, 409 U.S. 188, 192 (1972), this

9. Should this Court grant certiorari on any of the issues raised, it is respectfully requested that the Court also consider the applicability of *Blue Chip* to Debentureholders who neither purchase nor sell their Debentures.

Court stated that "it is the appellant or petitioner who asks the Court to overturn a lower court's decree".

It is the judgment which is appealed and not individual issues and it is the Appellant which seeks to reverse that judgment. Simply because three judges were on each side of the automatic assignment issue does not remotely imply that the Court was equally divided on the question of whether the judgment should be affirmed or reversed where a total of five judges voted in favor of affirmance of the judgment.¹⁰

III. There is No Authority Supporting the Automatic Assignment of Claims Under Section 10(b)

Petitioners have contended that there is a conflict between the Third Circuit and the Second Circuit on the issue of whether claims under §10(b) are automatically assigned to a subsequent purchaser of a security.¹¹ (Petition at p. 12). This is highly misleading. The Third Cir-

10. Cf. *Furman v. Georgia*, 408 U.S. 238 (1972). See also *Dred Scott v. Sandford*, 19 How. (60 U.S.) 393 (1856); *Smith v. U.S.*, 5 Pet. (30 U.S.) 292, 303 (1831) for other examples where this Court has acted on the basis of a plurality of minority opinions with respect to various matters at issue. This court has held that "[w]hen a fragmented Court decides a case and no single rationale explaining the result enjoys the assent of five Justices, 'the holding of the Court may be viewed as that position taken by those Members who concurred in the judgments on the narrowest grounds . . .'" *Marks v. U.S.*, 430 U.S. 188, 193 (1977).

11. The parties are in agreement that federal law is controlling in deciding this issue. See e.g. *In re Fine Paper Litigation*, 632 F.2d 1081 (3d Cir. 1980); *International Ladies' Garment Workers Union v. Shields & Co.*, 209 F. Supp. 145 (S.D.N.Y. 1962).

cuit is the only Circuit which has had occasion to consider this issue. The Second Circuit case cited by Petitioners, *Phelan v. Middle States Oil Corp.*, 154 F.2d 978 (2nd Cir. 1946), was a receivership case that had nothing at all to do with either Section 10(b) or any other Federal Securities Law. It in no way can it be interpreted as establishing a rule of automatic assignability under § 10(b). The only other cases involving the assignment of claims under § 10(b) involve *express* assignments or the survivability of such claims following the death of a party. *International Ladies Garment Workers Union v. Shields*, 209 F.Supp. 145 (S.D.N.Y. 1962); *Mills v. Sarjem Corp.*, 133 F.Supp. 753 (D.N.J. 1955).

The only case other than the present that has determined the issue of the automatic assignability of such claims is *Independent Investor Protective League v. Saunders*, 64 F.R.D. 564 (E.D. Pa. 1974). In *Saunders*, the court was confronted with the very question presented by the Petitioners: do claims under Section 10(b) travel with the security? The court gave a resounding "No":

While a security is of course transferred by its sale, the causes of action belonging to a prior holder do not pass with the transfer of the security. The provisions of the securities acts relied upon here create rights of action on the part of investors who have been harmed by the misconduct of others. Those rights belong to the *persons* who have suffered injury. They do not attach for all eternity to the security itself, to pass forever from the person who has been harmed to be asserted by others who have not. To adopt plaintiff's extraordinary theory would be to deprive injured persons of their rights and give their causes of action to one who has suffered no injury himself but who simply has been shrewd or lucky

enough to have put his hands on a security that once belonged to a person who was defrauded.

64 F.R.D. at 572.

Although not specifically referred to in *Saunders*, there is another factor which supports the contention that there can be no automatic assignment of § 10(b) claims. That is the language of §10(b) and rule 10b-5 themselves. Both prohibit the use of manipulative and deceptive devices "in connection with the purchase or sale of any security". See also *Blue Chip Stamps v. Drug Stores*, 421 U.S. 723 (1975). Any rule permitting the automatic assignment of such claims would have the effect of reading that language out of the statute and rule. This is so because a subsequent securityholder who purchases his security in an anonymous transaction on one of the national securities exchanges would be unable to prove that there was a purchase or sale of a security at the time of the fraud complained of since he could not possibly know when his transferor had purchased or sold his security. Only the transferor knows and is in a position to pursue his claim. Any other rule would render meaningless the "in connection with" language of Section 10(b).

There is yet a further reason the petitioners should not be found to have received an automatic assignment of their predecessors' claims. As noted in detail by Judge Garth these plaintiffs bought their Debentures with full knowledge of the dividend declaration and in doing so were speculating that they might be able to collect the dividend (10a-11a n.5).¹² Little wonder Judge Garth re-

12. Of course, since the plaintiffs were aware of the existence of such claims, there was nothing which prevented them from obtaining an express assignment of those claims.

fers to such persons as "corporate bounty hunters" (18a). To allow the securities laws to be used by such plaintiffs would only encourage the further speculation in lawsuits, ultimately to the detriment of all investors.

Petitioners, while acknowledging federal law controls, rely heavily upon New York state law in support for their position. Curiously enough, however, they fail to mention that under New York law, such speculation in lawsuits is specifically banned by N.Y. Jud. Law §489 (McKinneys 1968). Section 489 prohibits any purchase of a bond by a corporation such as the corporate plaintiff in this case with the intention of bringing suit on the bond.

CONCLUSION

Based upon the foregoing cases, authorities and arguments it is respectfully requested that the Court grant a writ of certiorari with respect to the issue of whether there has been a violation of Section 10(b) and Rule 10b-5 and that the Court deny the writ of certiorari as to the issues raised by the petitioners.

Respectfully submitted,

.....
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SUPPLEMENTAL APPENDIX

IN THE
UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

LUCILE LOWRY and
LOWRY-ZWEIG CORP.,
Plaintiffs,

v.

THE BALTIMORE AND OHIO RAILROAD
COMPANY, THE CHESAPEAKE & OHIO
RAILROAD COMPANY AND CHESSIE
System, Inc.,
Defendants.

Civil Action
No. 79-1504-B

**DEFENDANTS' MOTION FOR SUMMARY
JUDGMENT**

AND NOW come defendants, The Baltimore and Ohio Railroad Company ("B & O"), The Chesapeake and Ohio Railway Company ("C & O") and Chessie System, Inc. ("Chessie"), by and through their counsel, Richard T. Wentley, Anthony J. Basinski and Reed Smith Shaw & McClay and do hereby move this Honorable Court for an Order pursuant to Rule 56 of the Federal Rules of Civil Procedure granting all defendants summary judgment for the reason that there is no dispute as to any material fact and defendants are entitled to judgment as a matter of law and in support thereof do aver as follows:

1. Plaintiffs, Lucile Lowry and Lowry-Zweig Corp., brought a class action against defendants for violation of §10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, a trust indenture and a listing agreement with the New York Stock Exchange.

2. Plaintiffs are alleged to be present and past holders of certain B & O convertible debentures (the "Debentures").

3. Plaintiffs complain that they or their predecessors in interest were improperly denied notice of the payment of a dividend by the B & O to its shareholders of certain stock of a wholly-owned subsidiary of the B & O, Mid-Allegheny Corp.

4. Plaintiffs' claims against defendants are identical to those alleged by the plaintiffs in *Pittsburgh Terminal Corp. v. The Baltimore and Ohio Railroad Company, et al.*, C. A. 77-1455 and *Monroe Guttman v. The Baltimore and Ohio Railroad Company, et al.*, C. A. 79-94, which actions were tried before this Court on July 21-24, 1981.

5. On March 10, 1981, this Court issued its opinion and order in the *Pittsburgh Terminal* and *Guttman* actions dismissing all of the plaintiffs' claims and directing that judgment be entered in favor of all of the defendants.

6. Judgment was so entered on March 11, 1981.

7. The Court's decision in those cases necessarily decided the very issues presented by the instant case.

8. This Court may take judicial and/or actual notice of its findings of fact and conclusions of law in those matters in the present case:

A. "Plaintiffs have failed to establish that the corporate defendants had the requisite scienter to establish a violation of Section 10(b) and 10b-5." (Conclusion of Law No. 2).

B. "The Indenture does not require that any notice be given debentureholders of a dividend payable on the stock of a company other than the B & O because such a dividend is the equivalent of a cash dividend although payable in kind." (Conclusion of Law No. 6).

C. "Plaintiffs have failed to prove that they have a right to proceed on an implied cause of action for any breach of any listing agreement with the New York Stock Exchange or the Rules of said Exchange." (Conclusion of Law No. 7).

9. Furthermore, the Court is required by the principles of *stare decisis* to follow its prior decision in the *Guttmann* and *Pittsburgh Terminal* matters.

WHEREFORE, defendants above named respectfully request that this Honorable Court enter an order granting summary judgment in their favor on all of plaintiffs' claims for the reason that there is no dispute as to any material fact and defendants are entitled to judgment as a matter of law.

Respectfully submitted,

.....
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REED SMITH SHAW & McCLAY

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Counsel for Defendants

The Baltimore and Ohio

Railroad Company, The

Chesapeake and Ohio Railway

Company and Chessie System, Inc.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 81-1976

LUCILE LOWRY and LOWRY-ZWEIG CORP.,
Appellants
vs.

THE BALTIMORE AND OHIO RAILROAD
COMPANY,
THE CHESAPEAKE & OHIO RAILROAD COMPANY
AND CHESSIE SYSTEM INC.
(D.C. Civil No. 79-1504)

On Appeal From the United States District Court
For the Western District of Pennsylvania

Present: SEITZ, *Chief Judge*; ALDISERT, ADAMS,
GIBBONS, HUNTER, GARTH, SLOVITER and BECKER, *Circuit
Judges*.

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the Western District of Pennsylvania and was argued by counsel on December 16, 1981, and reargued before the Court in banc on November 8, 1982.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court, entered May 18, 1981, be, and the same is hereby affirmed insofar as it dismissed the federal claims of the appellants and vacated insofar as it dismissed the state law claims, and the cause remanded for proceedings consistent with the opinion of this Court. Each side to pay its own costs.

ATTEST:
SALLY MRVIS
Clerk

May 10, 1983

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May 11, 1981

Honorable William W. Knox
United States District Court
Western District of Pennsylvania
U.S. Post Office & Courthouse
Pittsburgh, PA 15219

Re: Lucile Lowry, et al. v. The Baltimore and Ohio
Railroad Company, et al. Civil Action No. 79-1504-B

Dear Judge Knox:

This relates to Your Honor's scheduling order of May 5, fixing May 15 for movants' brief, May 25 for respondents' brief and June 15 for oral argument on defendants motion for summary judgment.

It is my understanding that Your Honor invited defendants' motion. The short moving papers present three grounds for judgment, concluding that "the Court is required by the principles of *stare decisis* to follow its prior decision in the *Guttmann* and *Pittsburgh Terminal* matters." Our response which was filed on May 5, is also concise, acknowledging, at page 3, that your rulings in the *Guttmann* cases are adverse precedents.

Granting of the motion seems a foregone conclusion. As I believe Your Honor knows, the *Guttmann* plaintiffs

are appealing your post-trial decision. In this posture it would seem to be appropriate that the apparently inevitable dismissal of the *Lowry* action occur sooner rather than later, so that the Third Circuit may hear and decide your dismissals of the *Lowry* and *Guttmann* cases on a consolidated basis at one and the same time.

In short, there seems to be no need for the briefing and oral argument which Your Honor has scheduled. The matter seems already ripe for decision. Accordingly, I respectfully request that you withdraw your scheduling order and decide the motion on the present papers.

Sincerely
 ROBERT B. BLOCK
 Robert B. Block

RBB:rrf

cc: Richard T. Wentley, Esq.
 Michael P. Malakoff, Esq.

P.S. Please correct my name in your records to "Robert B. Block".

P.P.S. After conversation with counsel for the Baltimore & Ohio Railroad, they have authorized me to express their concurrence and joinder in the request for a decision of the Motion for Summary Judgment on the papers now before the Court.

IN THE
UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

LUCILE LOWRY and
LOWRY-ZWEIG CORP.,
Plaintiffs,

-against-

THE BALTIMORE AND OHIO RAILROAD
COMPANY, THE CHESAPEAKE & OHIO
RAILROAD COMPANY AND CHESSIE
System, Inc.,
Defendants.

No.
79-1504-B

NOTICE OF APPEAL

Notice is hereby given that Plaintiffs, Lucile Lowry and Lowry-Zweig Corp., appeal to the United States Court of Appeals for the Third Circuit from (a) the final and judgment dated May 15, 1981 granting the motion for summary judgment of Defendants, The Baltimore and Ohio Railroad Company, The Chesapeake & Ohio Railroad Company and Chessie System, Inc., and dismissing the action; and (b) from the orders dated April 7, 1980 and May 5, 1980 insofar as they narrow the class as defined in the complaint.

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SEP 17 1983

ALEXANDER L. STEVAS,
CLERK

No. 83-211

IN THE

Supreme Court of the United States

October Term, 1983

LUCILE LOWRY and LOWRY-ZWEIG CORP.,

Petitioners,

vs.

THE BALTIMORE & OHIO RAILROAD COMPANY,
THE CHESAPEAKE & OHIO RAILROAD COMPANY,
and CHESSIE SYSTEM, INC.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

PETITIONERS' REPLY BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

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No. 83-211

IN THE

Supreme Court of the United States

October Term, 1983

LUCILE LOWRY and LOWRY-ZWEIG CORP.,

Petitioners,

vs.

THE BALTIMORE & OHIO RAILROAD COMPANY,
THE CHESAPEAKE & OHIO RAILROAD COMPANY,
and CHESIE SYSTEM, INC.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

**PETITIONERS' REPLY BRIEF IN SUPPORT
OF PETITION FOR CERTIORARI**

Petitioners submit this Reply Brief in response to issues raised in respondents' Response to Petition.

**I. RESPONDENTS' CHALLENGE TO THE THIRD
CIRCUIT'S HOLDING ON § 10(b) LIABILITY IS NOT
PROPERLY BEFORE THIS COURT IN THE ABSENCE
OF A CROSS-PETITION**

Respondents invite this Court to deny certiorari with respect to the questions presented in the Petition, yet "grant review of this matter to affirm that there has been no violation of the

securities laws by the [respondents]." Resp. Br. p. 8. They have failed, however, to file a cross-petition which seeks this relief.

It has been consistently held that issues not raised in a petition or cross-petition for certiorari are not properly before the Court. *Lake Country Estates v. Tahoe Planning Agency*, 440 U.S. 391, 398 (1979). This doctrine is exemplified by *Federal Energy Administration v. Algonquin SNG, Inc.*, 426 U.S. 548, 560 n.11 (1976), where the respondents sought modification of the judgments below without cross-filing for certiorari. The Court held that because of such failure to cross-petition, respondents were "at this point precluded from seeking such modification." 426 U.S. at 560 n.11. Similarly, in *United States v. O'Brien*, 391 U.S. 367 (1968), the Government petitioned for certiorari and the defendant cross-petitioned but also briefed issues raised in neither the petition nor the cross-petition. This Court stated flatly, "[T]hose issues are not before the Court." 391 U.S. at 386 n.31.

Respondents here seek wholesale reversal of the Circuit Court's liability ruling. Such an objective may only be accomplished through the certiorari process. The attempt to circumvent that process should be rejected.

II. RESPONDENTS ARE COLLATERALLY ESTOPPED FROM RELITIGATING THE ISSUE OF § 10(b) LIABILITY

As detailed more fully in the Petition, whether petitioners have a federal claim turns on two discrete questions: (1) Did respondents violate § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b)? (2) If so, was a claim based on that violation assigned to petitioners by operation of law?

The first of these questions was put to rest by the decision in *Pittsburgh Terminal Corp. v. The Baltimore & Ohio R.R. Co.*, 680 F.2d 933 (3d Cir. 1982), an action which challenged precisely the same transaction as the case at bar and which was consolidated with this case on appeal. In *Pittsburgh Terminal*, the Third Circuit held that respondents' concealed dividend did violate § 10(b). Respondents sought *in banc* review, which was denied, and then petitioned this Court for a writ of certiorari,

which was also denied. See Supreme Court Docket Nos. 82-620; 82-622; 103 S.Ct. 476 (1982). Accordingly, assignment, *vel non*, is the only issue properly presented to this Court—primarily whether the court below was empowered to dismiss the § 10(b) claim in spite of the even division among the judges on the question of assignment and the District Court's refusal to dismiss for lack of an express assignment. See Pet. at pp. 7-12.

Notwithstanding the finality of the ruling on § 10(b) liability, respondents seize upon the Petition as an invitation to resurrect that foreclosed issue. The doctrine of collateral estoppel precludes wasteful relitigation of decided issues. In *Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 326 (1979), the Court observed that collateral estoppel "has the dual purpose of protecting litigants from the burden of relitigating an identical issue with the same party or his privy and of promoting judicial economy by preventing needless litigation." Accord, *Blonder-Tongue Laboratories, Inc. v. University of Illinois Foundation*, 402 U.S. 313, 328-29 (1971).

It is plain that all the requisites for application of collateral estoppel laid down by this Court in *Parklane Hosiery*, *supra*, 439 U.S. at 329-31, are satisfied here. First, petitioners did not seek to avoid being bound by a possible adverse judgment in *Pittsburgh Terminal* while retaining the right to exploit a favorable one. Consolidation at the District Court level was attempted but denied because *Pittsburgh Terminal*, which had been filed before *Lowry*, was ready for trial whereas *Lowry* was not. Later, at petitioners' instance, the cases were consolidated on appeal. Second, respondents were not required to litigate *Pittsburgh Terminal* in a forum where their rights to discovery, to call witnesses or to otherwise fully present their case were limited in any way. Third, respondents had sufficient financial stake in the *Pittsburgh Terminal* action (plus knowledge of the *Lowry* claims) to vigorously defend the action—as indeed they have. Finally, there are no prior judgments inconsistent with *Pittsburgh Terminal*.¹

¹ The Court of Appeals remanded *Pittsburgh Terminal* to the District Court for a determination of "appropriate relief." 680 F.2d at 943. This remand for a
(footnote continued)

Under these circumstances, there can be no doubt that collateral estoppel foreclosed respondents from relitigating their § 10(b) liability in the court below. Four of the six judges below who held for § 10(b) liability² regarded the panel's *Pittsburgh Terminal* liability ruling as controlling this case.³

Respondents have had their day, indeed many days, in court on the liability issue. True, as decided in *Pittsburgh Terminal*, liability might conceivably be reviewed by this Court at some later stage of that action, as suggested by cases cited at p. 4 n.2 of the Response. It in no way follows, however, that this Court should be called upon, in this case, to reverse a fully litigated determination in the earlier lawsuit. Such an undertaking could not co-exist with the collateral estoppel principle and policy fashioned by this Court and quite consistently understood and applied by courts below.

III. RESPONDENTS' "ADVICE OF COUNSEL" DEFENSE IS MERITLESS

We here address respondents' primary defense against § 10(b) liability, assuming, without in any way conceding, that that issue is properly presented in the absence of a cross-petition for certiorari and in light of the final liability determination in *Pittsburgh Terminal*, a discussed under Points I and II above.

Respondents contend that their "good faith reliance on the advice of counsel" precludes a finding of scienter, and hence liability under § 10(b). While reliance upon the advice of counsel might constitute a valid defense in some circumstances, to

limited purpose does not, of course, affect the finality of the holding on § 10(b) liability. *Lummus Co. v. Commonwealth Oil Refining Co.*, 297 F.2d 80, 89 (2d Cir. 1961), cert. denied, 368 U.S. 986 (1962); Restatement, Judgments (2d) (1982) § 13, Comment g (and Reporter's Note thereto, p. 141, citing cases from other Circuits which have adopted the *Lummus* rule).

² Gibbons, Garth, Sloviter, Adams, C.J.J.

³ Chief Judge Seitz and Judge Becker, who also held for § 10(b) liability, expressed concurrence in the substance of *Pittsburgh Terminal's* liability ruling and found it unnecessary to decide whether it bound the court sitting *in banc*.

so hold on the facts of this case would mark the effective repeal of § 10(b).

It is undisputed that advance notice of the MAC dividend was intentionally withheld by respondents so that their public debenture-holders would have no chance to convert and thus share in that dividend. The injury to debenture-holders—loss of the opportunity to convert into B&O stock which included the valuable non-rail assets; see Pet. at 4—was both substantial and plainly foreseeable.

Prior to effecting this scheme, respondents sought the advice of Robert F. Hochwarth, an attorney-employee of B&O. Another B&O employee, Roland Donnem, was also consulted. See Resp. Br. at 5-6. Both approved the transaction. Respondents concede, however, that “neither Hochwarth nor Donnem specifically considered whether notice had to be given pursuant to Rule 10b-17 [17 C.F.R. § 240.10b-17], the Third Circuit’s predicate for liability in the *Pittsburgh Terminal* case. . . .” Resp. Br. at 7. Furthermore, at no time was independent outside counsel asked for an opinion on the legality of the transaction.⁴

In *Fogel v. Chestnutt*, 533 F.2d 731, 749 (2d Cir. 1975), cert. denied, 429 U.S. 824 (1976), Judge Friendly was confronted with an analogous defense based upon reliance on the informal advice of inside counsel. He held:

Reliance on such obviously casual advice from a lawyer having a personal stake adverse to the shareholders affords no protection unless it is right—in which event it is unnecessary to assert the defense of reliance.

Here, respondents seek § 10(b) immunity based on the advice of their own employees which was concededly rendered without

⁴ Hochwarth did ask a “senior partner” of Hunton & Williams to “let me know if you see any problems with this procedure,” and no objection was forthcoming. Resp. Br. at 6. But there is no evidence that aside from this casual request and subsequent silence, Hunton & Williams was ever requested to, or did, research the law. Certainly, no written (or even verbal) opinion was rendered. To call such silence the “advice of counsel” and then raise it as a shield against § 10(b) liability is patently untenable.

consulting the relevant law. If such casual advice from affiliated attorneys were enough to protect one from § 10(b) liability, it would be hard to imagine an instance where a corporation could not grant itself immunity from prosecution by the simple expedient of having one of its own employees render a suitable opinion without even researching the law. Obviously, Congress could not have intended that § 10(b) be so easily avoided.⁵

IV. THE CIRCUIT WAS EQUALLY DIVIDED ON THE PIVOTAL ASSIGNMENT ISSUE, FOR WHICH REASON THE DISMISSAL OF FEDERAL CLAIMS SHOULD NOT STAND

Judge Gibbons, in his able and caustic dissent from the "Per Curiam Opinion of the Court" in this case, had this to say, among other things, concerning the integrity of that result:

[T]he method by which the court arrived at a judgment is fundamentally inconsistent with sound appellate practice in the courts of appeals and will bring this court into disrepute.

* * *

I would regard any effort to apply *res judicata* effect to a class action judgment predicated upon the concurrence of two legal propositions, neither of which commands a majority in the court which announced the judgment, to be a violation of due process of law.

* * *

Thus, this court's willingness to enter a judgment based on two propositions neither of which commands

⁵ Indeed, if respondents are correct, then in-house counsel, not the courts, will become the final arbiters of what actions constitute a violation of the securities laws.

Respondents' related argument, Br. at 12, that Rule 10b-17 contravenes the *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), requirement of scienter, overlooks that the *Pittsburgh Terminal* panel, 680 F.2d at 942, under the heading "*Scienter*", explicitly addressed that issue and found that respondents' conduct amply fulfilled the *Hochfelder* requirement.

a majority has accomplished nothing except to bring its appellate process into disrepute.

* * *

The entry of a judgment based on two legal propositions, neither of which commands a majority, is a disgrace to the judicial process.

(30a, 40a, 50a).

And further, in his "Statement re Denial of Petition for Modification of Judgment":

[I]f the Supreme Court is concerned about public perceptions as to the integrity of the federal appellate process, it should grant certiorari in this case and formally vacate the unsupportable judgment of this court.

(70a-70.1a).

Respondents' attempt to justify the Per Curiam Opinion boils down to these unfounded assertions:

A. The assignment issue (according to Respondents, Br. at 13, 14-15) was not properly before the Circuit since no party appealed the District Court's order denying defendants' first summary judgment motion (which explicitly challenged plaintiffs as late purchasers of the debentures (66a)). In actuality, the assignment question was fully briefed for the Circuit by both sides with no suggestion by respondents that the issue was not properly before the court; and the assignment question was virtually the court's sole preoccupation at the *in banc* rehearing where supplemental briefs were requested and filed on six issues relating solely to assignment (6a-7a).

B. The Per Curiam Opinion and Judgment should stand because (according to Respondents, Br. at 13-14, 16) appeals are taken from judgments, not from their reasoning; and, out of the eight sitting judges, two voted against liability and three voted against automatic assignment, making "a majority" of five for dismissal and affirmance. This of course overlooks, as stressed

by dissenting Judge Gibbons, that the purported majority consists of a minority on the liability question and half of the deadlocked six who addressed the assignment question, so that the result is utterly meaningless in terms of a meeting of a majority of judicial minds on any relevant issue or proposition.

Respondents, Br. at 16 n.10, cite four cases supposedly supportive of "the weird judgment in this case" (49a). None of those citations is remotely in point because none of them attained "a majority" by pooling minority votes on discrete, entirely unrelated issues, as in this case.

Thus, *Furman v. Georgia*, 408 U.S. 238 (1972), reversed the death sentences of three convicts, on the separate opinions of five Justices who concurred that the sentences were unconstitutional, although for differing reasons. In the infamous *Dred Scott v. Sandford*, 19 How. (60 U.S.) 393, 15 L.Ed. 691 (1856), seven Justices agreed that Scott was still a slave, the division within the majority was solely on whether the decision below, against Scott, should be affirmed on the merits or whether his complaint should be dismissed because he was not "a citizen" constitutionally entitled to sue in a court of the United States. In *Smith v. U.S.*, 5 Pet. (30 U.S.) 292, 8 L.Ed. 130 (1831), judgment was reversed on the strength of a plurality of minority opinions on the inauthenticity of the critical documentary evidence—again a single issue. *Marks v. U.S.*, 430 U.S. 188 (1977), respondents' fourth and last case, presumably is cited for a quoted dictum with no discernible application to the present Petition.

V. THE § 10(b) CLAIMS WERE ASSIGNED TO PETITIONERS BY OPERATION OF LAW

Respondents rely heavily on one District Court case, *Independent Investment Protective League v. Saunders*, 64 F.R.D. 564 (E.D. Pa. 1974), where, as noted in the Petition, p. 18 n.16, the assignment issue was inadequately presented to the court. Left unexplained by respondents is why federal receivership claims should travel with the bonds (as *Phelan v. Middle States*

Oil Co., 154 F.2d 978 (2d Cir. 1946) held) while federal securities law claims should not (as respondents would have it).

Respondents contend that automatic assignment would violate the "in connection with" requirement of § 10(b) discussed in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975). This argument proves too much; it would impugn *express* assignments as well (which even respondents concede are appropriate under § 10(b); see Resp. Br., pp. 17, 18 n.12). The related argument—that one could never know whether a prior holder had been fraudulently induced to purchase or sell his security; Resp. Br., p. 18—is inapposite in this case. Every B&O debenture-holder on December 13, 1977, the date of respondent's violation, was thereby defrauded. Automatic assignment avoids not only the formidable problems associated with tracing bearer securities (Pet., pp. 15-16), but also eliminates any possibility of double liability (*i.e.*, under state law to transferees and under respondents' view of federal law, to the original holders; Pet. 9, text and n.11)—two points which respondents do not address.

Respondents find it "curious" that the Petition makes no mention of N.Y. Jud. L. § 489 (McKinneys 1968) ("Purchase of claims by corporations and collection agencies"). No mention was made of this penal statute because it has no application to this case or the questions presented for review. Petitioner, Lucile Lowry, is neither a corporation nor a person engaged in the "business of collection and adjustment of claims." Accordingly, the statute has no effect whatsoever upon her claims, Petitioner, Lowry-Zweig Corp., though a corporation, is not in the collection business and did not purchase the B&O debentures for the sole purpose of bringing suit thereon, as New York law would require before § 489 becomes operative. *Sprung v. Jaffe*, 3 N.Y.2d 539, 544 (1957). In any event, whether § 489 comes into play here is a factual issue (*Fairchild Hiller Corp. v. McDonnell Douglas Corp.*, 28 N.Y.2d 325, 330 (1971)), never reached below and not before this Court now.

CONCLUSION

For the reasons stated above, and in the Petition, this Court should grant certiorari and reinstate petitioners' § 10(b) claim. Alternatively this Court should grant certiorari and rule upon the assignment issue.

Dated: New York, New York
September 16, 1983

Respectfully submitted,

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